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In the Supreme Court
OF THE
United States

OCTOBER TERM, 1974

No. 74-758

PROVIDENT SECURITIES COMPANY, a California corporation,
Cross-Petitioner,

vs.

FOREMOST-McKESSON, INC., a Maryland corporation,
Cross-Respondent.

CONDITIONAL CROSS-PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

JOHN B. BATES
NOBLE K. GREGORY
WALTER R. ALLAN
225 Bush Street, 19th Floor
San Francisco, California 94104
Telephone: (415) 983-1000
Attorneys for Cross-Petitioner

PERNAU-WALSH PRINTING CO. - 582 MISSION STREET - SAN FRANCISCO, CA 94105

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Cross-petitioner Provident Securities Company (hereinafter "Provident") has been advised that Foremost-McKesson, Inc. (hereinafter "Foremost") intends to file a petition for a writ of certiorari to review the judgment and the opinion of the United States Court of Appeals for the Ninth Circuit entered in this proceeding on September 19, 1974. Although the Ninth Circuit affirmed the judgment of the district court in favor of Provident, it

disagreed with the district court's opinion and it rejected or did not consider some other points raised by Provident on the appeal. As we shall discuss in our opposition to Foremost's petition, we believe that the opinion of the Court of Appeals is correct with respect to its reasons for affirming the judgment and that therefore the petition should be denied. However, if this Court should determine to grant Foremost's petition for a writ of certiorari, Provident will wish to present all its arguments to this Court. This conditional cross-petition for a writ of certiorari is filed to avoid any question as to its right to do so.[1]

OPINIONS BELOW

The opinion of the district court (Appendix A hereto) is reported at 331 F.Supp. 787. The opinion of the Court of Appeals (Appendix B hereto) is unofficially reported at CCH Federal Securities Law Reporter, ¶94,811 (p. 96,703).

JURISDICTION

The judgment of the Court of Appeals was entered on September 19, 1974. No petition for rehearing was filed. This Court has jurisdiction under 28 U.S.C. § 1254(1).

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[1]Because the Court of Appeals affirmed the judgment in favor of Provident, we believe that if Foremost's petition were to be granted it would be appropriate for Provident to raise grounds in support of the judgment, including those rejected or not considered in the opinion below (*Stelos Co. v. Hosiery Corp.* (1935) 295 U.S. 237, 239; *Langnes v. Green* (1931) 282 U.S. 531, 535). This cross-petition is filed as a precautionary measure in order to avoid any doubt as to Provident's right to raise those grounds.

QUESTIONS PRESENTED

All questions presented in this cross-petition involve interpretation and application of § 16(b) of the Securities Exchange Act of 1934 (48 Stat. 896, 15 U.S.C. § 78p(b)). Those questions are:

1. Does the potential for actual speculative abuse test enunciated in this Court's opinion in *Kern County Land Co. v. Occidental Corp.* (1973) 411 U.S. 582 apply to an exchange of assets for securities, in which exchange no cash was paid for the securities and the recipient of the securities wished only to receive cash for its assets?

2. Does there exist a potential for actual speculative abuse when a corporation, which is liquidating by selling its holdings and thereafter distributing its assets to its shareholders, has no access to inside information with respect to the purchaser of its assets and receives its purchaser's securities—shortly thereafter sold as a part of the liquidation—solely as an accommodation to the purchaser?

3. When, under an underwriting agreement, a seller of securities retains possession and the incidents of ownership and cannot benefit from a rising market and is not insulated from a falling one, is the date of the sale the date of the underwriting agreement or the actual date of transfer of the securities and relinquishment of the incidents of ownership?

4. Under a plan of complete corporate liquidation pursuant to state law, may the corporate legal owner of securities be divested of beneficial ownership and its shareholders vested with such beneficial ownership so that

§ 16(b) will apply to transactions by those beneficial owners and not by the legal owner?

5. Under a plan of complete corporate liquidation pursuant to state law, may a corporate legal owner of securities become a liquidating agent or other similar person authorized to administer the assets of its shareholders so as to render any sale of the assets exempt from § 16(b) under Securities and Exchange Commission Rule 16a-4 (17 C.F.R. § 240.16a-4)?

STATUTES AND REGULATIONS INVOLVED

The sections of the Securities Exchange Act of 1934 (48 Stat. 881, 15 U.S.C. §§ 78a, et seq.) involved in this case are §§ 3a(13), 3a(14), 16(a) and 16(b). Also involved is Securities and Exchange Commission Rule 16a-4 (17 C.F.R. § 240.16a-4) and sections of the California Corporations Code. Those sections are reproduced in Appendix C hereto.

STATEMENT OF THE CASE

A. The proceedings below.

Provident filed this action seeking a declaration of nonliability. Foremost counterclaimed seeking a declaration of liability and recovery of asserted profits. Both parties moved for summary judgment and the district court gave judgment for Provident, holding that the transaction did not involve a potential for speculative abuse of inside information (Appendix A, pp. viii-xi).

On appeal by Foremost, the Court of Appeals affirmed but on other grounds. It held (Appendix B, pp. xiv-xix) that the potential for speculative abuse test was not applicable because the transaction was "essentially a cash-for-stock transaction" and that, in any event, there did exist a potential for speculative abuse. It also rejected (Appendix B, pp. xix-xxii) Provident's argument that the date of sale fell after such time that Provident had become a holder of less than 10% of any equity security of Foremost. It affirmed the judgment (Appendix B, pp. xxii-xl) because Provident had not owned any Foremost securities when it entered into the transaction here in question and therefore was not a "beneficial owner" of "more than 10 per centum of any class" of Foremost securities "at the time of the purchase" (15 U.S.C. § 78p(a), (b)).

B. The facts.

The basic facts of this case are undisputed:

Provident, now dissolved, was a personal holding company incorporated under the laws of California for the purpose of managing various assets for the benefit of its shareholders (R.,[2] p. 391). In late 1968, Provident tentatively decided to liquidate and to distribute its assets, or the proceeds from a sale thereof, pro rata to its shareholders (R., p. 391). After investigation of various proposals, Provident decided to pursue negotiations on a proposal under which Foremost would purchase most of Provident's assets (R., p. 392). Extensive negotiations followed between Provident and Foremost regarding the form of the transaction and the nature of the considera-

[2]The clerk's record in the court below is cited herein as "R., p. ....."

tion to be paid. During these negotiations, Foremost had full access to Provident's books and records and Foremost made a complete appraisal of all of Provident's assets (R., pp. 251-252).

To facilitate liquidation and dissolution, Provident was interested in selling to Foremost for cash (R., p. 392). Foremost, however, insisted that the major portion of the purchase price should be in securities of Foremost to be issued expressly for that purpose (R., p. 392). Although Provident argued that Foremost should sell securities itself if it wanted to use them to finance the purchase of Provident's assets, Foremost remained adamant on this point (R., p. 392). Compromise eventually was reached under which Foremost agreed to take such steps as were necessary to accommodate the sale, as promptly as possible following the closing of the purchase, of one half of the securities to be transferred to Provident (R., pp. 392-393).

The purchase agreement provided that Foremost would purchase approximately two thirds of Provident's assets in exchange for cash and Foremost convertible subordinated debentures which were to be issued expressly for the purpose of acquiring Provident's assets (R., pp. 393, 411-451). It also provided that, following the closing of the agreement, Provident could distribute to its shareholders, as part of its plan of liquidation and dissolution, the Foremost debentures delivered pursuant to the purchase agreement (R., p. 393). The debentures, however, would not be marketable without the prior written consent of Foremost unless registered under the Securities Act (R., p. 418).

With respect to the debentures which were to be sold by Provident's shareholders after the distribution, Foremost agreed to use its best efforts to file a registration statement as soon as practicable after the date of the agreement (R., pp. 393-394, 418-419). Foremost also agreed to enter into an underwriting agreement whereby those debentures would be sold to the public (R., pp. 394, 418-419).

On September 26, 1969, the Provident Board of Directors recommended dissolution and additionally recommended ratification of the purchase agreement executed the previous day (R., pp. 395, 499-500). At a shareholders' meeting later the same day, Provident's shareholders elected to dissolve and a plan of complete liquidation was adopted (R., pp. 395, 501-510). The agreement was then approved by the shareholders (ibid.).

The Form S-1 registration statement, filed by Foremost with the Securities and Exchange Commission on September 29, 1969, anticipated that the offering would be made by the Provident shareholders who were to receive the debentures in a liquidating distribution by Provident (R., pp. 394, 530, 536). Early in October, 1969, however, difficulties were encountered with respect to the proposed public offering by Provident's shareholders (R., p. 397). In particular, it was impossible to get consents to sell from the minor shareholders without the appointment of guardians; in addition, one shareholder was somewhere in the Brazilian jungles and could not be contacted (R., pp. 397-398). To resolve this problem, Foremost agreed to a change in the Purchase Agreement so that Provident,

instead of its shareholders, might sell the debentures (R., pp. 269, 398-399, 688-702).

At a meeting on October 13, 1969, the Provident Board of Directors declared the first liquidating dividends, directing distribution of all of Provident's assets "pro rata to shareholders of record * * * as expeditiously as possible" (R., pp. 396-397, 680).

At the closing of the agreement on October 15, 1969, Foremost delivered a check and debentures to Provident (R., p. 399). Prior to receipt of the debentures, Provident had no legal or beneficial ownership in any security of Foremost (R., p. 391). On October 20, Provident instructed the First National City Bank, as trustee, to distribute pro rata to Provident's shareholders the debentures which were not to be sold (R., pp. 399-400). The actual mailing of those debentures took place on October 24, 1969 (R., p. 400).

On October 21, 1969, an underwriting agreement covering the remaining debentures was executed by Foremost, Provident and the underwriters (R., pp. 400, 707-719). That agreement defined "the time of purchase" as "9:45 A.M., on October 28, 1969" and provided that Provident would deliver the debentures and receive payment at that time (R., pp. 707-708).

Later on the same day that the underwriting agreement was signed (October 21), an amended S-1 registration form filed by Foremost covering those debentures became effective (R., pp. 628-678; Foremost Opening Brief, p. 23). That form had been amended to provide that the sale would be made through Provident and that "the proceeds of the sale of the Debentures offered hereby and the re-

maining Debentures issued or to be issued to Provident will be distributed by Provident to its shareholders in a liquidating distribution" (R., p. 643).

At the closing on October 28, the underwriters delivered $25,366,666.66 to Provident through New York clearing house funds, and Provident delivered the debentures in the principal amount of $25,000,000 to the underwriters (R., p. 400). After waiting the necessary 24 hours for the check drawn on the New York clearing house funds to clear, Provident distributed the cash to its shareholders (R., p. 400).

Liquidation proceedings continued throughout late 1969 and 1970 (R., pp. 400-401). On August 31, 1970, Provident was declared dissolved by court order and its remaining assets were transferred to a liquidating trust (R., pp. 401, 726-739).

REASONS FOR GRANTING WRIT

As discussed above (supra, pp. 1-2), the Court of Appeals affirmed the judgment in favor of Provident but, in doing so, it rejected some of Provident's arguments and did not consider others. Provident has filed this cross-petition for a writ of certiorari solely as a precautionary measure because it has been advised that Foremost intends to file a petition for a writ of certiorari.

Inasmuch as the Court of Appeals correctly affirmed the judgment (as we shall show in our opposition to Foremost's petition for a writ of certiorari) and inasmuch as the questions discussed herein involve matters either mis-

understood or ignored in the court's opinion, the questions presented might not be sufficiently important to justify an independent petition for a writ of certiorari. However, if this Court should grant Foremost's petition, we submit that it should review the entire case.

I. AN EXCHANGE OF ASSETS FOR STOCK IS AN "UNORTHODOX" TRANSACTION WHICH SHOULD BE EXAMINED FOR A POTENTIAL FOR ACTUAL SPECULATIVE ABUSE.

This Court, in holding that "certain 'unorthodox' transactions" might not be subject to § 16(b), has noted that "traditional cash-for-stock transactions that result in a purchase and sale or a sale and purchase within the six-month, statutory period are clearly within the purview of § 16 (b)" *(Kern County Land Co. v. Occidental Corp.* (1973) 411 U.S. 582, 593). The Ninth Circuit erroneously stated that it was not necessary to examine the transaction herein for a potential for speculative abuse because it viewed that transaction as "*essentially* a cash-for-stock transaction" (Appendix B, p. xvi; emphasis added).

Despite the Ninth Circuit's characterization, the transaction herein was *not* an exchange of cash for stock; it involved an exchange of assets for cash and securities. In effect, Provident was merged into Foremost and it received cash and Foremost debentures as consideration in that merger. Professor Loss has noted that an "unorthodox" transaction may be involved in "the acquisition of securities of one company in exchange for the assets of another" (Loss, Securities Regulation (Supp.2d Ed. 1969) Vol. 5, p. 3029). Similarly, in *Kern,* this Court noted that

"unorthodox" transactions would include "exchanges pursuant to mergers or other corporate reorganizations" (411 U.S. 593, ftn. 24).

Provident had not entered the market with cash seeking to purchase securities. Instead, Provident's sole motivation was to dispose of its assets in exchange for cash which was to be distributed to its shareholders in the liquidation. It is undisputed, as the district court pointed out, that Provident did not want any Foremost stock and that it accepted the debentures only because of Foremost's insistence (Appendix A, pp. ii-iii, xi). There thus exists a quite meaningful distinction between this transaction and a traditional cash-for-stock transaction. That distinction pertains to the manner of acquisition. If a cash purchase is involved, then there may be a reasonable presumption that the purchaser wanted to acquire the stock which he purchased and that he may have intended to engage in speculation with that stock. If there is no cash involved, then there may not have been any wish to acquire the stock and, accordingly, no intent to speculate.

Therefore, the transaction should be examined to determine whether it involved a potential for actual speculative abuse. We submit that the court below erred in its characterization of the transaction and in its conclusion that the potential for speculative abuse should not be examined.

II. THE TRANSACTION INVOLVED NO POTENTIAL FOR ACTUAL SPECULATIVE ABUSE.

As discussed above, the Ninth Circuit determined that the transaction should not be examined for a potential for speculative abuse and that § 16(b) was automatically applicable to it. Nonetheless, the court did examine the transaction and, in doing so, it considered two factors:

> "(1) Could [Provident] reasonably be expected to have had access to inside information? And (2) did [Provident] initiate the transaction voluntarily?" (Appendix B, p. xvii).

The Court of Appeals erred in its discussion of the matters pertinent to both these inquiries.

First, the Ninth Circuit correctly noted that the presumption of access to inside information could be rebutted (Appendix B, p. xviii). However, it erroneously held that Provident had not rebutted that presumption because it had "not demonstrated that the Foremost management was hostile" (Appendix B, p. xviii). In *Kern*, this Court examined the facts to ascertain whether "Occidental either had or was likely to have access to inside information, by reason of its ownership of more than 10% of the outstanding shares of Old Kern, so as to afford it an opportunity to reap speculative, short-swing profits" (411 U.S. 596). From the *fact* that Old Kern's management was hostile, this Court *inferred* that the likelihood of possession of inside information was remote (411 U.S. 598).

Plainly, if the presumption of access to inside information can be rebutted by such an inference, it can also be rebutted by other facts. Here, it is undisputed that the negotiations between the parties related solely to the

evaluation of *Provident's assets* which were to be transferred to Foremost. During that time, it was Foremost that had complete access to Provident's books and records (R., pp. 251-252) but there was no reason for Provident to have, and it did not have, any access to Foremost's books and records. There has therefore never been any contention that Provident's brief status as an "insider" gave it any access to inside information (Appendix A, p. ix).

Second, the Ninth Circuit's emphasis on the "voluntary" nature of the transaction was misplaced. In *Kern,* involuntariness was again a *fact* involved in the stock conversion transaction. However, the voluntary nature of the transaction is not necessarily a controlling factor. This is made clear by the portion of this Court's opinion which discussed the subsequent stock option transaction—a wholly voluntary transaction—and concluded that there was no potential for speculative abuse in that transaction (411 U.S. 601-604). This view is consistent with that of the Second Circuit which has previously pointed out that the voluntary nature of a transaction is not determinative (*Blau v. Lamb* (2 Cir. 1966) 363 F.2d 507, 520).

As in *Kern,* Provident had no prior association with Foremost and owned no Foremost securities before its acquisition of the debentures. Therefore, Provident could not be found liable because of any hypothetical speculative calculations prior to the acquisition because any such calculations "could not have been based on inside information obtained from substantial stockholdings that did not yet exist" (411 U.S. 597). Also, as in *Kern,* there was no access to information after the acquisition. The court

below therefore erred in its conclusion that there existed a potential for speculative abuse.

III. THE SALE OF THE DEBENTURES OCCURRED WHEN PROVIDENT WAS NOT AN OWNER OF 10% OR MORE OF A CLASS OF FOREMOST'S SECURITIES.

The underwriting agreement was signed on October 21, 1969 (R., pp. 400, 707-719) and it provided that October 28 was to be "the time of purchase" when Provident would deliver the debentures and receive payment (R., pp. 707-708). On October 24, 1969, Provident distributed to its shareholders other Foremost debentures held by it so that, as Foremost conceded in the proceedings below, the remaining debentures to be sold constituted "less than 10% of the class of outstanding common stock" (Foremost Opening Brief, p. 23). At the closing on October 28, the remaining debentures were transferred to the underwriters and Provident received its payment (R., p. 400). Because possession and the incidents of ownership were not transferred until October 28, that date should be considered the date of sale (*Champion Home Builders Co. v. Jeffress* (6 Cir. 1974) 490 F.2d 611, 616). On October 28, Provident was not an owner of 10% or more of a class of Foremost's securities and § 16(b) liability therefore could not attach (15 U.S.C. § 78p(b); *Reliance Electric Co. v. Emerson Electric Co.* (1972) 404 U.S. 418, 423-425).

The Court of Appeals, however, erroneously held that October 21 was the date of sale because on that date, in its view, Provident was "irrevocably bound" to sell (Appen-

dix B, p. xxi). Because of its mistaken belief that Provident had insulated itself against all market risks (Appendix B, p. xxi), the court ignored the rule that a firm commitment, standing alone, does not necessarily give rise to a purchase or sale under § 16(b) (*Champion Home Builders Co. v. Jeffress* (6 Cir. 1974) 490 F.2d 611, 616).

The court below made reference only to paragraph 7 of the underwriting agreement which permitted termination under certain adverse conditions until such time as the registration statement became effective. The statement became effective on October 21 and the court concluded that therefore the agreement was not subject to termination after that date. In reaching that conclusion, the court overlooked the fact that, under paragraph 5(h), the agreement was subject to the express condition

> "That, between the time of execution of this agreement [October 21] and the time of purchase [October 28], there shall occur no material and unfavorable change, financial or otherwise (other than as referred to in the Registration Statement and the Prospectus), in the condition of the Company [Foremost] and its consolidated subsidiaries as a whole * * *" (R., p. 713).

Therefore, Provident could not have obtained speculative advantage through the October 21 agreement. Provident could not share in a rising market and, because the agreement was terminable under adverse conditions, it was not insulated from a falling one. Possession and ownership rights were not transferred until October 28 and that, accordingly, was the date of sale (cf. *Kern County Land Co. v. Occidental Corp.* (1973) 411 U.S. 582, 602).

IV. PROVIDENT HELD THE FOREMOST DEBENTURES SOLELY FOR THE BENEFIT OF ITS SHAREHOLDERS AND THEREFORE THE TRANSACTION WAS NOT SUBJECT TO § 16(b).

This case also involves certain questions pertaining to "beneficial ownership" which were not considered in the opinions below. The record demonstrates that at all pertinent times Provident was acting solely for the benefit of its shareholders. A plan of complete liquidation had been approved *prior* to the acquisition of the Foremost debentures. Under California law, this required Provident to cease all business other than "beneficial winding up" and also required distribution of all assets to the shareholders (Cal.Corp.Code §§ 4600, 4605, 5000).

We submit that, under these circumstances, § 16(b) was not applicable to the sale of the Foremost debentures because Provident's shareholders, not Provident, were in fact and in law the beneficial owners of those debentures. We also submit that Provident had become a liquidating agent or other similar person authorized by California law to administer the assets of its shareholders, rendering the transaction exempt under Securities and Exchange Commission Rule 16a-4 (17 C.F.R. § 240.16a-4).

We have not presented here all the factual detail pertaining to these points. If, however, this Court should take up this case, we expect to argue these points in full.

CONCLUSION

For the foregoing reasons, we respectfully submit that in the event that the Court should grant Foremost's petition for a writ of certiorari in this case, this cross-petition should likewise be granted.

JOHN B. BATES
NOBLE K. GREGORY
WALTER R. ALLAN
Attorneys for Cross-Petitioner

(Appendices Follow)

Appendix A

In The United States District Court For The Northern District Of California

Provident Securities Company, a California Corporation, Plaintiff, vs. Foremost-McKesson, Inc., a Maryland corporation, Defendant.	C-70 460 RHS OPINION

This is an action for declaratory relief brought by Provident Securities Company, a dissolved California corporation, to determine its nonliability to Foremost-McKesson, Inc. for short-swing profits under §16(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78p(b).

Foremost has filed a counterclaim seeking a declaration of such liability. The matter is before the Court on cross motions for summary judgment and partial summary judgment[1] and would appear to be ripe for such disposition since there does not appear to be any dispute as to the facts.

Provident (now dissolved) was a "family" corporation incorporated under the laws of California in 1915 by the four children of W. H. Crocker for the purpose

[1]The Foremost motion would leave for future determination the amount of such liability.

of managing various assets for the benefit of themselves and their heirs. Its shareholders were the descendants of these four children.

In late 1968, it was decided by those interested that different objectives among the heirs and tax considerations dictated that Provident should either be liquidated or sold and the assets or proceeds from the sale distributed pro rata to the shareholders.

One of the corporations interested in acquiring Provident or its assets was Foremost. After investigation of various other proposals, Provident favored a proposal made by Foremost whereby Foremost would purchase most of Provident's assets. Provident would then liquidate and dissolve by distributing to its shareholders its remaining assets and the consideration received from Foremost for its other assets.

Within these broad outlines, there were extensive negotiations between Provident and Foremost regarding the form of the transaction and the nature of the consideration to be paid by the latter.

To facilitate liquidation and dissolution of the company, Provident was primarily interested in selling to Foremost for cash, but Foremost, for reasons of its own, wished to pay the major portion of the purchase price in securities of Foremost, namely, 6 per cent convertible subordinated debentures due June 15, 1994, to be issued expressly for this purpose. In response to this, Provident argued that if Foremost wanted to use debentures to finance the purchase of Provident's assets, it should sell its own debentures and pay Provident in cash, but this was not acceptable to Foremost.

In an attempt to accommodate Foremost, Provident next stated that it would agree to accept convertible debentures instead of cash provided Foremost agreed to use its best efforts to insure that Provident could sell all of the debentures received at a public offering as soon as possible after the closing of the purchase. Again, Foremost was not willing to accept Provident's suggestion and after extensive negotiations, compromise was reached whereby Foremost agreed to affect registration under the Securities Act of 1933 of up to one half of the debentures to be delivered as payment for Provident's assets and to enter into an underwriting agreement as promptly as possible following the closing of the purchase whereby up to one half of the debentures would be publicly sold by an underwriting group.

On September 25, 1969, a Purchase Agreement was executed by Foremost and Provident which provided that Foremost would purchase approximately two-thirds of Provident's assets for a purchase price of $54,000,000 (subject to certain adjustments) consisting of $4,450,000 in cash and $49,750,000 aggregate principal amount of Foremost's 6 per cent convertible subordinated debentures due June 15, 1994, which were issued expressly for the purpose of acquiring Provident's assets.[2]

The agreement further provided that following the closing of the purchase agreement, Provident could distribute to its shareholders, as part of its plan of liquidation and dissolution, the Foremost debentures delivered pursuant to the Purchase Agreement but that these de-

[2]All of the debentures issued were in fact used for that purpose.

bentures would not be marketable without prior written consent of Foremost unless registered under the Securities Act of 1933. Both the debentures and any common stock issued on conversion were to be legended as follows:

> "The transfer of this security is subject to the conditions specified in a Purchase Agreement dated September 25, 1969, between Foremost-McKesson, Inc. and Provident Securities Company and no transfer of this security shall be valid or effective until such conditions have been fulfilled."

The agreement also provided that Foremost would use its best efforts to cause a registration statement covering an aggregate principal amount of debentures up to $25,000,000, i.e. approximately one-half of the total to be issued, to be filed under the Securities Act of 1933 as soon as practicable after the date of the agreement (September 25, 1969) and agreed to enter into an underwriting agreement whereby the debentures so registered would be sold to the public. It was initially contemplated that all of the debentures delivered to Provident by Foremost in payment for Provident's assets would be distributed in kind to Provident's shareholders and that Provident's shareholders would then be named as the selling debenture holders in the above-mentioned underwriting agreement.

The Purchase Agreement was set to close on October 15, 1969, and contained numerous conditions which had to be satisfied before either party would be bound to close, among which was a condition that the holders of at least one-half of the outstanding common stock of Provident approve and adopt a proposal that Provident be wound

up and dissolved and adopt a plan of complete liquidation of Provident and that the holders of at least one-half of the outstanding common stock and the holders of at least two-thirds of the outstanding preferred stock of Provident approve and ratify the execution of the Purchase Agreement.

As early as September 3, 1969, the Board of Directors of Provident resolved to recommend to the shareholders dissolution and winding up of the corporation and adoption of a plan of complete liquidation and distribution of the corporate assets to the shareholders.

Simultaneously with negotiations for this agreement Provident's Board of Directors and shareholders began procedures necessary for winding up and dissolving the corporation.

On September 29, 1969, Provident filed a certificate of election to wind up and dissolve with the California Secretary of State and mailed notice of intention to wind up and dissolve to all of its creditors and shareholders.

On the same date, Foremost filed a Form S-1 registration statement with the Securities and Exchange Commission pursuant to the Securities Act of 1933 covering the $25,000,000 aggregate principal amount of the Foremost debentures pursuant to which the Provident shareholders, as sellers, would offer the $25,000,000 aggregate principal amount of debentures distributed to them as a liquidating distribution by Provident. This S-1 form was amended on October 3, 1969.

Early in October of 1969, Provident realized that there were several difficulties in having the shareholders them-

selves make the public offering of the $25,000,000 aggregate principal amount of Foremost debentures following distribution of the same to them. Certain of the shareholders were minors and one of the shareholders could not be contacted. The problem was discussed with Foremost, and Foremost orally agreed to a change in the Purchase Agreement so that Provident itself, instead of its shareholders, might sell the $25,000,000 principal amount of debentures. This was really no more than a change in form since by the terms of the Purchase Agreement as originally drawn, Foremost was committed to enter into an underwriting agreement authorizing the immediate sale of $25,000,000 principal amount of Foremost debentures. At a meeting of the Provident shareholders on October 13, 1969, Provident obtained the consent of two-thirds of the preferred stockholders and a majority of the common stockholders to this change and on October 15, 1969, Foremost formally consented in writing to the alteration, and it was incorporated in amendment No. 2 to the S-1 registration form filed on October 21, 1969.

At the closing on October 15, 1969, Foremost delivered to Provident a check for $4,250,000 and a debenture in the principal amount of $40,000,000. Pursuant to the agreement, $2,500,000 principal amount of debentures were delivered to Bank of America National Savings and Trust Association as an escrowholder. The remaining $7,250,000 principal amount of debentures due under the agreement were delivered on October 20, 1969.

After receipt of the debenture in the principal amount of $40,000,000, Provident had it split into two parts, one of $15,000,000 and the other of $25,000,000. Upon receipt

of the final $7,250,000 principal amount of debentures on October 20, Provident executed bond powers to effect transfer of the $7,250,000 and the $15,000,000 aggregate principal amount of debentures pro rata to its shareholders pursuant to a liquidating resolution of the Board previously adopted on October 13, 1969. Instructions to make this distribution were mailed to First National City Bank as trustee under the indenture covering the debentures on October 21, 1969, and the actual mailing of the debentures took place on October 24, 1969. After this distribution, there remained in Provident's possession $25,000,000 aggregate principal amount of debentures. On October 21, 1969, the registration statement under the Securities Act of 1933 covering the $25,000,000 aggregate principal amount of debentures became effective and in accordance with the Purchase Agreement of September 25, 1969, an underwriting agreement between Foremost, Provident and Dillon, Read & Co., Inc., as representative of the underwriting group, covering the $25,000,000 of debentures was executed by all parties. This underwriting agreement closed on October 28, 1969. At the closing, the underwriters delivered $25,366,666.66 to Provident through New York clearing house funds, and Provident delivered the debenture in the principal amount of $25,000,000 to the underwriters. Shortly thereafter Provident distributed cash to its shareholders in the amount of $29,623,500 (including the funds received from the underwriters).

Throughout October of 1969, there were other liquidating dividends paid to Provident's shareholders consisting both of cash and of various securities as the process of liquidation and winding up proceeded.

Section 16(b) provides:

> "For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

Foremost contends for a starkly literal reading of Section 16(b), which would make Provident, by virtue of its short-lived position as holder of the convertible debentures of Foremost, accountable to it as provided in 16(b)

for the relatively small profit resulting from the underwriting described above, without regard to the overall character of the transaction and its ultimate effect. It makes no claim that any of the evils against which 16(b) were directed were present in this, or that Provident derived inside information, profit or advantage from its all-but-momentary status as an "insider" of Foremost.

To require Provident to pay over to Foremost the amount the latter seeks under Section 16(b) would be to confer a complete windfall upon Foremost and would be utterly at war with any concept of equity known to this Court.

Fortunately, the Courts, mindful of Justice Holmes's oft-quoted canon of statutory construction, by which "[a word] is but the skin of a living thought", have not felt required to apply 16(b) in all cases regardless of concomitant equities and circumstances. In the leading case in this Circuit, Judge Browning, speaking for a unanimous Court, enjoins us that in construing Section 16(b):

> "The initial inquiry must therefore be: What is the purpose of section 16(b)—what practices is the statute designed to prevent." *Blau v. Max Factor & Company*, 342 F.2d 304, 307 (9th Cir.), certiorari denied 382 U.S. 892.

Likewise, the Eighth Circuit has said:

> "There is, however, a very different and difficult problem when a transaction falls within the literal boundaries of the Act, by giving a broad interpretation of the definitions of purchase as 'any contract to buy, purchase or otherwise acquire,' and sale as 'any contract to sell or otherwise dispose of,' yet due to the particular factual situation which makes unfair

> speculation impossible it is clearly beyond the Act's preventive purposes. In that situation the question arises, should the Act be literally applied without further inquiry and without regard to the purposes, or should the broad and arbitrary rules be applied only to situations which are capable of the abuse that the statute was designed to prevent? We believe that each case must be examined on its own facts and the Act only applied when these facts disclose the possibility of abuses that the Act were designed to prevent." *Petteys v. Butler,* 367 F.2d 528, 533 (8th Cir.).

It is sometimes said that Section 16(b) sets forth merely a "crude rule of thumb", the inference being drawn that if the facts, without regard to the purposes of the statute, the surrounding circumstances and the equities inherent therein, are such as are described in that section, the courts have no alternative but to impose liability. However, as to this, the Second Circuit has said:

> "The description, 'a crude rule of thumb,' was first employed by Mr. Thomas Corcoran, spokesman for the drafters of the statute, during congressional hearings on the bill which ultimately became section 16(b). Hearings Before Senate Committee on Banking & Currency, 73d Cong., 2d Sess. 6557 (1934). The phrase now serves to describe not only the statute but also one approach to its application. Under the 'objective' or 'rule of thumb' approach, the statute is applied to all transactions which seem to fall within its terms, without regard to whether imposition of liability would further the purposes of the statute. See, e.g., Heli-Coil Corp. v. Webster, 352 F.2d 156 (3d Cir. 1965). We have rejected this interpretation, see Blau v. Lamb, 363 F.2d 507 (2d Cir. 1966), cert. denied 385 U.S. 1002, 87 S.Ct. 707, 17 L.Ed. 2d 542

(1967), in favor of the more 'pragmatic' approach of applying the statute only to those situations subject to speculative manipulation. For a comparative analysis of the two approaches to application of the statute, which concludes that this Circuit's rule is preferable, see Note, Stock Exchanges Pursuant to Corporate Consolidation: A Section 16(b) 'Purchase or Sale'?, 117 U.Pa. L.Rev. 1035 (1969." *Newmark v. RKO General, Inc.*, 425 F.2d 348, 350, n.).

"The threshold issue raised on this appeal is whether the purchase and subsequent exchange of Central shares lent itself to the type of speculative abuse which section 16(b) was designed to prevent. Blau v. Lehman, 286 F.2d 786 (2d Cir. 1960) aff'd, 368 U.S. 403, 82 S.Ct. 451, 7 L.Ed. 2d 403 (1962); Park & Tilford, Inc. v. Schulte, 160 F.2d 984 (2d Cir.) cert. denied, 332 U.S. 761, 68 S.Ct. 64, 92 L.Ed. 347 (1947)" (emphasis added). *Id.*, at p. 353.

Even a cursory view of the facts presented herein are enough to show that to decide for Foremost would require application of an extremely crude rule of a most deformed and misshapen thumb. In all its essential details the form of the transaction was insisted upon if not dictated by Foremost, often contrary to the plans and wishes of Provident. If the matter had been handled as Provident wished, this case could never have arisen. To allow Foremost under these circumstances to recover the small profit of Provident (almost miniscule in terms of the total amounts involved) simply by a mindlessly literal application of Section 16(b) would be to perpetrate rather than correct an inequity. This the Court is unwilling to do.

Summary judgment will accordingly be rendered for Provident.

Appendix B

United States Court Of Appeals
For The Ninth Circuit

Provident Securities Company, a California corporation, Plaintiff-Appellee, vs. Foremost-McKesson, Inc., a Maryland corporation, Defendant-Appellant.	No. 71-2965 OPINION

[September 19, 1974]

Appeal from the United States District Court
for the Northern District of California

Before: ELY, TRASK and WALLACE, Circuit Judges.

WALLACE, Circuit Judge:

Provident Securities Company (Provident) filed this action, seeking a declaration of nonliability for short-swing profits under section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78p(b). Foremost-McKesson, Inc. (Foremost) counterclaimed, seeking a declaration of liability and recovery of the profits. Both parties moved for summary judgment and the district court found in favor of Provident, holding that the Provident-Foremost transaction did not fall within section 16(b) since it did not involve the potential for speculative abuse

of inside information condemned by the Act. *Provident Securities Co. v. Foremost-McKesson, Inc.*, 331 F.Supp. 787 (N.D. Cal. 1971). We affirm, but on other grounds.

Provident (now dissolved) was a holding company owned by the descendants of W. H. Crocker. In the fall of 1968, it tentatively decided to liquidate its assets and hired Dillon, Read & Company to analyze its financial structure and to seek a purchaser which in turn led to Provident negotiating with Foremost. Initially Provident hoped to sell its assets for cash since cash would be easy to distribute to its shareholders. But eventually it compromised and accepted convertible debentures, one half of which would be registered as soon as possible after closing so that the stock could be offered to the public.

On September 25, 1969, pursuant to this compromise, Provident and Foremost executed a purchase agreement which provided that Foremost would purchase approximately two-thirds of Provident's assets for $54,000,000, consisting of $4,250,000 in cash and $49,750,000 in Foremost six percent convertible subordinated debentures. On October 15, 1969, the closing was held under the purchase agreement. At that time Foremost delivered to Provident a check for $4,250,000 and a debenture in the principal amount of $40,000,000. This debenture was subsequently split into two debentures in the principal amounts of $25,000,000 and $15,000,000. At the time of closing and in Provident's behalf, Foremost also delivered to an escrow agent a debenture in the principal amount of $2,500,000. The debentures were immediately convertible into common stock in an amount in excess of 10 percent of Foremost's outstanding shares. At the completion of the sale, Provi-

dent became a beneficial owner of more than 10 percent of a class of Foremost equity securities as provided in section 16(a) of the Act, 15 U.S.C. §78p(a). On October 20, 1969, Foremost delivered to Provident an additional debenture in the principal amount of $7,250,000.

The following day, October 21, 1969, Provident, Foremost and Dillon, Read & Company, as representative of the underwriting group (Underwriters), executed an underwriting agreement providing for the sale by Provident of the debenture in the principal amount of $25,000,000 to Underwriters at a price of $25,366,666.66. On October 24, 1969, Provident distributed debentures to its shareholders in the aggregate principal amount of $22,250,000. At this point Provident ceased to be a 10-percent shareholder of Foremost stock.

On October 28, 1969, the closing under the underwriting agreement was held and Provident transferred the $25,000,000 debenture to Underwriters in exchange for a check in the amount of $25,366,666.66. The following day, after waiting the necessary time for the check to clear, Provident distributed the cash to its shareholders. On August 31, 1970, following the completion of liquidation proceedings, Provident was dissolved and its remaining assets transferred to a liquidating trust.

A. *The Threshold Test—Potential for Speculative Abuse*

Section 16(b) of the Securities Exchange Act was enacted to prevent corporate officers, directors and principal shareholders from profiteering in inside information through short-swing speculation. The section was designed to discourage corporate insiders from reaping profits

from fluctuations in the price of their corporation's stock that were predictable on the basis of inside information.[1]

Consistent with this statutory purpose, the Supreme Court in *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582, 595 (1973), recently adopted a pragmatic approach that subjects short-swing transactions by an insider to section 16(b) scrutiny only if they involve the potential for speculative abuse of inside information. As a prerequisite to the *Kern County* threshold test, however, the Court indicated that there must be an "unorthodox" transaction such as "stock conversions, exchanges pursuant to mergers and other corporate reorganizations, stock reclassification, and dealings in options, rights, and warrants." 411 U.S. at 593 n.24. The Court's examples of "unorthodox" transactions were probably not intended to be all inclusive but suggest that if the transaction is cash-for-stock or essentially cash-for-stock, then the *Kern County* threshold rule should

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[1]The Senate Report on the bill that became the Securities Exchange Act explained the purpose of section 16(b) as follows:

> The bill further aims to protect the interests of the public by preventing directors, officers, and principal stockholders of a corporation, the stock of which is traded in on exchanges, from speculating in the stock on the basis of information not available to others. Any change in the holdings of such insiders must be reported to the Commission, and profits realized from the purchase and sale, or the sale and purchase of an equity security within a period of less than 6 months are recoverable by the corporation. Such a provision will render difficult or impossible the kind of transactions which were frequently described to the committee, where directors and large stockholders participated in pools trading in the stock of their own companies, with the benefit of *advance information* regarding an increase or resumption of dividends in some cases, and the passing of dividends in others.

S. Rep. No. 792, 73rd Cong., 2d Sess. 9 (1934) (emphasis added).

not be applied. In the orthodox case, the transaction must be tested against the literal terms of the section.

The Provident-Foremost transaction was essentially a cash-for-stock transaction. Provident purchased Foremost debentures, convertible immediately into a large block of common stock, in exchange for two-thirds of its assets. There was no substantial period of delay between the initial agreement and the exchange of consideration. The rights and obligations of the parties were fixed when the purchase agreement was executed. The purchase price did not depend on a formula that was tied to the price of the stock on the market, *cf. Booth v. Varian Associates,* 334 F.2d 1 (1st Cir. 1964), *cert. denied,* 379 U.S. 961 (1965), but was fixed at the time of agreement. The transaction was not merely a record-keeping maneuver, *cf. Blau v. Max Factor & Co.,* 342 F.2d 304 (9th Cir.), *cert. denied,* 382 U.S. 892 (1965), but was an actual transfer of stock for assets. Given these facts there is no reason to treat the Provident-Foremost transaction as anything other than an orthodox sale of stock. As Professor Loss writes:

> Conversion and merger-like transactions aside, the voluntary exchange of securities, either for assets or for other securities, at least of a different issuer, is ordinarily as much a "purchase" or "sale" as if the consideration had been cash.

2 L. Loss, Securities Regulation 1072 (2d ed. 1961) (footnote omitted).

Provident argues that the transaction was in reality not a purchase, but rather a sale of assets. It points out that it originally preferred cash, but, at Foremost's insis-

tence, compromised to accept convertible stock. But even though this assertion may be correct, it does not alter the nature of the transaction for section 16(b) purposes. Provident exchanged its assets for Foremost stock. The only distinction between this transaction and the usual cash-for-stock sale is the nature of the consideration. In all other respects the transaction was orthodox. *See Stella v. Graham-Paige Motors Corp.*, 132 F.Supp. 100, 102-03 (S.D.N.Y. 1955), *modified*, 232 F.2d 299 (2d Cir.), *cert. denied*, 352 U.S. 831 (1956). We see no meaningful distinction between consideration in the form of cash and consideration in the form of a corporate asset. Consequently, as was implicit in *Kern County*, the actual-potential-for-abuse threshold test is not relevant to our determination since that potential is presumed if the elements of the section are satisfied.

But even if the Provident-Foremost transaction were unorthodox, it involved the potential for speculative abuse of inside information and, therefore, is subject to section 16(b) scrutiny. Under the *Kern County* rule it is not necessary that the plaintiff prove actual abuse; the transaction must be subjected to scrutiny if there is a potential. 411 U.S. at 595; *see Smolowe v. Delendo Corp.*, 136 F.2d 231 (2d Cir.), *cert. denied*, 320 U.S. 751 (1943); *The Supreme Court, 1972 Term—Liability for Insider Trading Under Section 16(b)*, 87 Harv. L. Rev. 291, 295-96 (1973). In determining whether a transaction has that potential, the *Kern County* Court looked primarily to two factors: (1) Could the defendant reasonably be expected to have had access to inside information? And (2) did he initiate the transaction voluntarily? 411 U.S. at 596-600.

Section 16 requires that we presume that a stockholder who owns 10 percent of his corporation's stock has access to inside information. Apparently, Congress assumed that a 10-percent shareholder would generally have sufficient control of the corporation to have such access.[2] Where, however, the hostility of the management of the corporation to the 10-percent shareholder precludes any real possibility of access to inside information, as in the *Kern County* tender offer situation, the presumption may be rebutted and the court may conclude that he in fact did not have access. 411 U.S. at 598. Provident has not demonstrated that the Foremost management was hostile. To the contrary, the general cooperation involved in the transaction would indicate that Provident conferred intimately with the Foremost management and could well have had access to confidential corporate information.

The second factor the Supreme Court considered in *Kern County* was whether the transaction was voluntary. Implicit in the decision is the limitation that the *Kern County* rule of leniency should not be applied where the defendant could have avoided section 16(b) liability without serious detriment. *See The Supreme Court, 1972 Term—Liability for Insider Trading Under Section 16(b)*, 87 Harv. L. Rev. 291, 300-01 (1973). There is no evidence in this case to suggest that Provident was forced to enter into any of the transactions. There is evidence, however, to show that Provident's management was aware of the section 16(b) problem and entered the transaction in spite of the possibility that it might be held liable for the

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[2]See the testimony quoted in note 5, *infra*.

profits. Provident has not suggested that it would have suffered any detriment had it not completed the transactions when it did. Absent a showing of involuntariness, we would not be justified in applying the *Kern County* rule.

After Provident became the owner of more than 10 percent of Foremost's stock, it might have had access to inside information which it could have abused for its speculative advantage. For example, assume Provident learned that Foremost had decided not to declare a dividend in order to maintain the capital it would need to develop the real estate just acquired from Provident. On the basis of this information, Provident might have reasoned that the market value of Foremost stock would rise in response to the news of the acquisition and then fall in response to the news of the decision not to declare a dividend. Provident might have concluded that it should sell its stock just after the acquisition news, but just before the dividend news, became public. Such trading is exactly the kind of speculative abuse that section 16(b) is designed to discourage. Thus, even if we assume that the Provident-Foremost transaction was unorthodox, we are required to subject it to section 16(b) scrutiny.

B. *Section 16(b) Scrutiny—The Closing Transaction*

Under section 16(b) the issuer of nonexempt securities may recover from a beneficial owner of 10 percent of its outstanding stock any profits realized from the purchase and sale or sale and purchase of the issuer's stock within a period of six months. Foremost argues that the $366,666.66 that Provident received in excess of the principal

amount of the debenture it sold to Underwriters is a short-swing profit to an insider and thus, under section 16(b), it may be recovered by Foremost as the issuer. At the outset we are faced with the question of when, for purposes of section 16(b), Provident's sale of the debenture to Underwriters was completed. If the sale was completed on October 21, the date the underwriting agreement was executed, Provident was a beneficial owner of 10 percent of Foremost's outstanding stock and we must decide if the remaining requirements of section 16(b) have been satisfied. On the other hand, if the sale was not completed until October 28, the date of the closing and a date subsequent to the distribution of debentures to the shareholders, then Provident was not a beneficial owner of 10 percent at the time of sale, and Foremost cannot recover the profit. *Reliance Electric Co. v. Emerson Electric Co.*, 404 U.S. 418 (1972).

Federal law governs the construction of terms used in the Securities Exchange Act. *Tcherepnin v. Knight*, 389 U.S. 332, 337-38 (1967). *Cf. Blau v. Lehman*, 368 U.S. 403 (1962). Thus, the question of when a sale is complete for purposes of section 16(b) must be decided so as to foster the goals of the federal legislation rather than under concepts of when title passes under state law. *Bershad v. McDonough*, 428 F.2d 693, 696-97 (7th Cir. 1970), cert. denied, 400 U.S. 992 (1971); *see SEC v. National Securities, Inc.*, 393 U.S. 453, 467 (1969). In making this determination, the courts have looked to that point at which the insider has relinquished his ability to control the transaction to the extent that he no longer has the potential to use inside information to his own advantage

and to the detriment of the public or outside shareholders. *See, e.g., Booth v. Varian Associates,* 334 F.2d 1 (1st Cir. 1964), *cert. denied,* 379 U.S. 961 (1965). This ability to control is generally relinquished when the insider is irrevocably bound to sell a specific number of shares at a fixed price, even though the formalities necessary for the transfer of title may not have yet occurred. *Kern County Land Co. v. Occidental Petroleum Corp.,* 411 U.S. 582 (1973); *Booth v. Varian Associates,* 334 F.2d 1 (1st Cir. 1964), *cert. denied,* 379 U.S. 961 (1965); *Blau v. Ogsbury,* 210 F.2d 426, 427 (2d Cir. 1954).

On October 21, when Provident executed the underwriting agreement, it was bound and the price was fixed. After that date, Provident no longer had the potential to use inside information to manipulate the terms and conditions of the agreement. As to Provident, the sale was at that date complete, subject only to the usual conditions precedent to closing.

Provident argues that its obligations under the underwriting agreement were conditional until after closing. But Provident's obligations were conditioned only by the requirements that the registration statement become effective on the date of the agreement, that no stop order issue prior to closing and that Foremost furnish Provident with an opinion letter on the legality of the transaction. None of these conditions subjected Provident to any market risks after the date of the agreement. If the value of Foremost stock had declined in response to the public disclosure of adverse inside information, Provident would nevertheless have received the same price for the stock.

One condition in the agreement, however, may have prevented Provident, for a limited period of time, from benefiting from any possible misuse of adverse inside information. Section seven of the agreement gave Underwriters the right to terminate the agreement prior to the time that the registration statement became effective if in its judgment there had occurred "a material unfavorable change in political, financial or economic conditions generally." Presumably, if the price of Foremost stock had fallen substantially in response to unfavorable information that had become public between the time of execution and the time the registration statement became effective, Underwriters could have terminated the agreement. Nevertheless, the condition does not alter the posture of this case since the registration statement, as required by the agreement, became effective on the same date that the agreement was executed.

We hold that for purposes of section 16(b) the sale of stock was completed on October 21, the date that the underwriting agreement was executed, and not on October 28, the date of closing. On the date of sale, therefore, Provident was the beneficial owner of 10 percent of Foremost's stock.

C. *The Initial Transaction*

In order for section 16(b) liability to attach, however, the insider must have owned 10 percent of the issuer's stock both at the time of purchase and of the sale. The relevant part of the statute reads: "This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the

purchase and sale, or the sale and purchase, of the security involved. . . ." The correct construction of this language has been the basis of a number of law review commentaries,[3] but there have only been three prior cases that have analyzed it.

The first case in which a court analyzed this language was *Stella v. Graham-Paige Motors Corp.*, 104 F.Supp. 957 (S.D.N.Y. 1952), in which Judge Kaufman concluded that the language "at the time of" must be construed to mean "simultaneously with," rather than prior to. Thus, he held that the initial purchase in which a person becomes the owner of 10 percent of the issuer's stock is a section 16(b) transaction and that a sale within six months serves as the closing transaction, subjecting the seller to liability for any profit. Judge Kaufman's primary rationale for this conclusion was that if the language were construed to mean "prior to," the owner of a large block of stock could reduce his holdings to below 10 percent and then repurchase without liability attaching. 104 F.Supp. at 959.

When the case eventually came before the Second Circuit, the court approved Judge Kaufman's construction without analysis. 232 F.2d 299, 300-01 (2d Cir.), *cert. denied*, 352 U.S. 831 (1956). Judge Hincks dissented, arguing that the initial purchase should not be a transaction within the scope of section 16(b). He reasoned that the language is clear, thus making it inappropriate for the court to go beyond the express terms of the statute and to consider

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[3]*See, e.g.*, Munter, *Section 16(b) Of The Securities Exchange Act of 1934: An Alternative To "Burning Down The Barn In Order To Kill The Rats,"* 52 Corn. L. Q. 69 (1966); Comment, *Section 16(b): An Alternative Approach To The Six-Month Limitation Period*, 20 U.C.L.A. L. Rev. 1289 (1973); 57 Colum. L. Rev. 287 (1957); 70 Harv. L. Rev. 1312 (1957); 9 Stan. L. Rev. 582 (1957).

what Congress must have intended. He further reasoned that the Securities Exchange Act is directed at eliminating the profit to be gained by corporate fiduciaries through speculating on the basis of advance information. A 10-percent shareholder, he argued, is presumed to have access to such information because of the control he has over the corporation; but to conclude that a person has access to such information prior to the purchase in which he became a 10-percent shareholder ignores the rationale of the presumption. 232 F.2d at 304-05.

A district court in the Eighth Circuit adopted Judge Hinck's approach without analysis. *Arkansas Louisiana Gas Co. v. W. R. Stephens Investment Co.,* 141 F.Supp. 841, 847 (W.D. Ark. 1956). Fourteen years later the Court of Appeals for the Eighth Circuit, the only other court to discuss the issue, adopted Judge Kaufman's approach. *Emerson Electric Co. v. Reliance Electric Co.,* 434 F.2d 918 (8th Cir. 1970), *aff'd,* 404 U.S. 418 (1972). On the rationale that any other view would weaken the statute, the court held that the purchase by which a person becomes a 10-percent shareholder can be one of a pair of transactions necessary for section 16(b) liability. Although acknowledging that the congressional intent is "not as clear as desirable," the court concluded that such a construction was consistent with Congress' purpose in enacting the section.

When *Emerson Electric* came before the Supreme Court, the Court noted the issue, but declined to resolve it because a cross-petition for certiorari had not been filed. 404 U.S. at 421. The Court did, however, repeatedly emphasize that the owner must hold 10 percent "both at the

time of purchase and sale." 404 U.S. at 419, 423 and 424. Slightly more than a year later the Court again had the issue before it, but again declined to resolve the issue by deciding the case on other grounds. In *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582, 584 (1973) the Court said:

> Unquestionably, one or more statutory purchases occur when one company, seeking to gain control of another, acquires more than 10% of the stock of the latter through a tender offer made to its shareholders. But is it a § 16(b) "sale" when the target of the tender offer defends itself by merging into a third company and the tender offeror then exchanges his stock for the stock of the surviving company and also grants an option to purchase the latter stock that is not exercisable within the statutory six-month period?

The Court held that the transactions involved in the case before it did not have the potential for speculative abuse of inside information and thus were not within the scope of section 16(b). In view of the Court's repeated emphasis of the language "both at the time of sale and purchase" in *Emerson Electric,* it is unclear whether its statement in *Kern County* was intended to resolve the question of whether the initial purchase is a section 16(b) transaction. Since the Court noted that "one or more statutory purchases occur" during a tender offer, it may have intended that the statutory purchases occur after the purchaser has acquired 10 percent.

This conclusion seems to be required by the Court's later statement that a tender offeror's calculations that he may be able to resell the stock at a profit to a partner of a defensive merger

> do not represent the kind of speculative abuse at which the statute is aimed, for they could not have been based on inside information *obtained from substantial stockholdings that did not yet exist.* Accepting both that Occidental [the tender offeror] made this very prediction and that it would recurringly be an accurate forecast in tender-offer situations, we nevertheless fail to perceive how the fruition of such anticipated events would require, or in any way depend upon, the receipt and use of inside information.

411 U.S. at 597 (emphasis added and footnote omitted). Since a person making a decision to purchase enough stock to increase his holdings to 10 percent of a corporation's outstanding shares could not have made that decision "based on inside information obtained from substantial stockholdings," the Court must have intended for section 16(b) to apply only after that person becomes a statutory insider.

This construction of "at the time of" is supported by the legislative history surrounding the enactment of section 16(b). An early draft of the section read:

> (b) It shall be unlawful for any director, officer, or owner of securities, owning as of record and/or beneficially more than 5 per centum of any class of stock of any issuer, any security of which is registered on a national securities exchange—
>
> (1) To purchase any such registered security with the intention or expectation of selling the same security within six months; and any profit made by such person on any transaction in such a registered security extending over a period of less than six months

> shall inure to and be recoverable by the issuer, irrespective of any intention or expectation on his part in entering into such transaction of holding the security purchased for a period exceeding six months.

Hearings on S. Res. 84, S. Res. 56 and S. Res. 97, Before the Senate Com. on Banking & Currency, 73d Cong., 1st Sess., pt. 15, at 6430 (1934) [hereinafter cited as *1934 Hearings*]. As is apparent from this draft, the section was originally designed to deter insiders from purchasing stock without any intention of making a long-term investment, but only with the intention of profiting from upward fluctuations in the market price that were predictable on the basis of inside information. The section was directed against an insider who has no intention of changing his investment relationship to the corporation, but rather has an "intention or expectation" to purchase and sell the stock within six months. After the pair of transactions is completed he intends to own exactly the same interest in the corporation as he owned before he began his speculative venture. *See Blau v. Max Factor & Co.,* 342 F.2d 304, 308-09 (9th Cir.), *cert. denied,* 382 U.S. 892 (1965); Comment, *Section 16(b): An Alternative Approach to the Six-Month Limitation Period,* 20 U.C.L.A. L. Rev. 1289, 1294-95 (1973).

The limitation period was set arbitrarily at six months since the speculative advantage to be gained from inside information is usually short lived; the fluctuations in the market price generally occur for only a short period of time after the inside information becomes known to the public. After a period of six months little speculative advantage remains. See Comment, *The Scope of "Pur-*

chase and Sale" Under Section 16(b) Of The Exchange Act, 59 Yale L. J. 510, 511 (1950).

As originally drafted the section did not cover the situation where an insider, with inside information adverse to the corporation and indicating a decline in the market price, would sell a large block of stock and later repurchase at a greatly reduced price. Thomas Corcoran, one of the drafters of the section and counsel to the Senate committee, testified as follows:

> Senator BULKLEY. Do you provide for the converse of that, where a man might sell for a short term with the intention of repurchasing?
>
> Mr. CORCORAN. No; it should have been provided for. No; I do not think you need to, sir, because the next section prevents selling short.
>
> Senator BULKLEY. It would not be selling short. He might be a large stockholder, and sell his own stock with the intention of repurchasing.
>
> Mr. CORCORAN. The bill does not cover that case. I do not know whether it should or not.
>
> Senator BULKLEY. Is that not just as reprehensible as to take a short turn on the up side?
>
> Mr. CORCORAN. You see, the next provision prevents either short selling, or selling against the box.
>
> Senator BULKLEY. It would not be a short sale.
>
> Mr. CORCORAN. Or selling against the box.
>
> Senator BULKLEY. It would not be against the box. It would be his own stock.
>
> Mr. CORCORAN. You mean a case where he sold the stock, and within 6 months bought it back at a lower price?
>
> Senator BULKLEY. Yes. A man having a large amount of stock might know that his company was going to pass a dividend, and then sell it with the intention of purchasing after the news was out.

> Mr. CORCORAN. Possibly a provision to catch that should go into the statute. That does not happen as often as the other case.

1934 Hearings, supra, at 6557-58.

Apparently in response to Senator Bulkley's suggestion, the language of the section was amended to read:

> [A]ny profit realized by [a statutory insider] from any purchase and sale, or *any sale and purchase,* of any equity security of such issuer . . . within any period of less than six months . . . shall inure to and be recoverable by the issuer . . . . (Emphasis added.)

Although the amended language includes a sale and repurchase by an insider, there is no indication that the amendment was designed to alter the section's goal of deterring insiders from speculating on the basis of inside information obtained because of "substantial stockholdings." Indeed, the amended version articulates this goal even more clearly than the original draft. In addition to the "purchase and sale, or sale and purchase" language, Congress added a preamble enunciating that the section was enacted.

> [f]or the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by *reason of his relationship* to the issuer . . . .

15 U.S.C. § 78p(b) (emphasis added).

The drafters recognized, however, the difficulty of proving that the insider actually intended a short-swing transaction when he made his original decision. Mr. Corcoran, after reading the draft section to the committee, testified:

> That is to prevent directors receiving the benefits of short-term speculative swings on the securities of their own companies, because of inside information. The profit on such transaction under the bill would go to the corporation. You hold the director, irrespective of any intention or expectation to sell the security within 6 months after, because it will be absolutely impossible to prove the existence of such intention or expectation, and you have to have this crude rule of thumb, because you cannot undertake the burden of having to prove that the director intended, at the time he bought, to get out on a short swing.

1934 Hearings, supra, at 6557. In order to ameliorate this difficulty of proving intention or expectation, the section created a statutory presumption that a person with access to inside information who purchases and sells, or sells and repurchases, within a six-month period does so with the intent to speculate rather than to invest. That the drafters intended for the presumption to be conclusive is clear from the following testimony:

> Senator GORE. You infer the intent from the fact.
>
> Mr. CORCORAN. From the fact.
>
> Senator KEAN. Suppose he got stuck in something else, and he had to sell?
>
> Senator BARKLEY. All he would get would be what he put into it. He would get his original investment.
>
> Mr. CORCORAN. He would get his money out, but the profit goes to the corporation.
>
> Senator KEAN. Suppose he had to sell.
>
> Mr. CORCORAN. Let him get out what he put in, but give the corporation the profit.

1934 Hearings, supra, at 6557.

Since the presumption of intention or expectation is conclusive,[4] it is necessary that it be narrowly construed so as to apply only to the class of persons who can reasonably be expected to have access to inside information. The hearings demonstrate that Congress intended that the class not be defined too broadly. As originally drafted the presumption applied, in addition to corporate officers and directors, to shareholders who owned five percent of a corporation's stock. The Senate Committee was concerned that a person with that percentage of shares may not have access to inside information[5] and increased the ownership to 10 percent.

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[4]The Supreme Court has recently rejected an argument that section 16(b) should be construed as creating a rebuttable presumption. *See* Reliance Electric Co. v. Emerson Electric Co., 404 U.S. 418, 438 (1972) (Douglas, J., dissenting).

[5]Senator Kean expressed his concern as follows:

> Senator KEAN. I think it is all right to apply it to a director or officer, but I think to require the ordinary investor—
>
> Mr. CORCORAN. Five percent is a lot in a modern corporation. Many corporations are controlled by 5 percent or 10 percent.
>
> Senator KEAN. They may own it or they may sell it. This applies to all corporations, and you are getting down to the point where you are interfering with the individual a good deal there. I agree with you with respect to the officers and directors.
>
> Mr. CORCORAN. A stockholder owning 5 percent is as much an insider as an officer or director. Whether he is a titular director or not, he normally is, as a practical matter of fact, a director.
>
> Senator KEAN. He might not be.

Hearings on S. Res. 84, S. Res. 56 and S. Res. 97, Before the Senate Comm. on Banking & Currency, 73rd Cong., 1st Sess., pt. 15, at 6556 (1934) [hereinafter cited as *1934 Hearings*].

Samuel Untermeyer, an attorney from New York on whose expertise the Committee greatly relied, testified of the same concern:

> Mr. PECORA. The theory was that the ownership of 5 percent of the stock would practically constitute him an insider,

As the Committee testimony indicates, the section also creates a presumption that officers, directors and 10-

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and by virtue of that position he could acquire confidential information which he might use for his own enrichment by trading in the open market, against the interests of the general body of the stockholders. That is the main purpose sought to be served.

Mr. UNTERMEYER. I understand the purpose, and I understand the wisdom of it.

Mr. PECORA. You approve of the principle?

Mr. UNTERMEYER. I approve of the principle, but I do not approve of its application to anybody who owns 5 percent, who is not an officer or director, and has no fiduciary relationship.

Mr. PECORA. If you were to raise that limitation to 20 percent of a listed or registered security, you probably would have difficulty in having it apply to any individual, because it is a grave question whether, in any listed security, there is any individual who owns 20 percent or more of the outstanding stock.

Mr. UNTERMEYER. If he owns less, and is not an officer or director—

Senator KEAN. If he is a director or officer, I think it should apply.

Mr. UNTERMEYER. I agree. I think it should apply. But if he is not—if he has no relation whatever to the corporation, except that he is an investor and owns that amount of security, I do not see why these penalties should be applied to him. They are too severe.

. . .

Mr. PECORA. The only point I want to make is that with that evidence in mind, that management control of an active stock could be obtained through control of 10 percent of the outstanding stock—and there was a large amount of stock outstanding—where an individual owned as much as 5 percent or more, he would be in a position, through the ownership of a block of stock of that size, to virtually be an insider, and he could very well dictate, with one or two others, elections to the board of directors.

Mr. UNTERMEYER. So, you will not let anybody acquire over 5 percent.

Mr. PECORA. It is open to anybody to do it, but he cannot use the information to trade for his own account against the public interest.

Mr. UNTERMEYER. But he cannot get any profit out of it. He is foreclosed from making anything out of it, and the result is that he will not buy it.

Mr. PECORA. He can profit from it provided his transactions are more than 6 months apart. It is designed avowedly

percent shareholders fall within the class of persons who may reasonably be expected to have access to inside information (statutory insiders). It does not appear, however, that this presumption (as distinguished from the presumption of intent to speculate) is always conclusive, since the Supreme Court has held that at least in some situation it may be rebutted. *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582 (1973).

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to prevent insiders from utilizing their position to trade for their own account and against the interests of the general body of the stockholders. The only penalty against it, as you have observed, is that he has to disgorge his profits for the benefit of all the stockholders.

Mr. UNTERMEYER. That is a penalty that will prevent him from buying any more stock, and you will hurt the market in the stock. He may have to buy to protect the stock.

Mr. PECORA. If he buys and does not sell again for another 6 months, he does not have to account.

Mr. UNTERMEYER. But he may just buy for the purpose of protecting the stock, and he may want to sell it as soon as he can. He may not be an insider at all. There are many corporations owned or controlled by big banking houses that have not 1 percent of the stock. They know more about it. They have got more information than the follow (sic) who owns 30 percent of the stock. They know all about it because they are running it. To take one extreme case, like the Wiggin case, and predicate legislation of this kind upon it is very dangerous because, as you know, Mr. Pecora, hard cases make bad laws.

. . .

Mr. UNTERMEYER. I must say [the section] is likely to do more harm than good.

THE CHAIRMAN. You think that that 5 percent ought to be made 20?

Mr. UNTERMEYER. I think so—15 or 20; some substantial amount.

Senator KEAN. Mr. Untermeyer, would it not be satisfactory if you made it apply to the officers or directors?

The CHAIRMAN. That is another provision.

Mr. UNTERMEYER. I think that 5-percent provision should apply to the officers and directors, but I do not think it should apply to anybody who wants to accumulate a larger amount than 5 percent of the stock.

Id. at 7741-43.

Nevertheless, the legislative history demonstrates that the class was not intended to include outsiders. As originally drafted subsection (b)(3) of the section provided that profits received by outsiders from short-swing speculation entered on the basis of confidential information received from insiders could be recovered by the issuer.[6] The provision was deleted from the final draft apparently because the burden of proof required to support a recovery was thought to be too difficult.[7] Since the original draft of the section contained a subsection expressly imposing liability on outsiders and a subsection expressly

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[6]At one time prior to passage, subsection (b)(3) provided:

> (b) It shall be unlawful for any director, officer, or owner of securities, owning as of record and/or beneficially more than 5 per centum of any class of stock of any issuer, any security of which is registered on a national securities exchange——
>
> . . .
>
> (3) To disclose, directly or indirectly, any confidential information regarding or affecting any such registered security not necessary or proper to be disclosed as a part of his corporate duties. Any profit made by any person, to whom such unlawful disclosure shall have been made, in respect of any transaction or transactions in such registered security within a period not exceeding six months after such disclosure shall inure to and be recoverable by the issuer unless such person shall have had no reasonable ground to believe that the disclosure was confidential or was made not in the performance of corporate duties.

1934 Hearings, supra, note 5, at 6430.

[7]The following testimony indicates the Committees concern over the difficulties in proving an abuse of inside information:

> Mr. CORCORAN. Subparagraph (3) affects the friends to whom these corporation directors and officers and big stockholders pass on a tip that the stock is going up for a short swing, and through whom they may conceal their own operations, since the friend may be simply acting as an agent through whom the director, officer, or principal stockholder effects the transaction for his own benefits.
>
> . . .
>
> Senator CAREY. That would mean that if an oil company expected to bring in a well, and an officer knew of it and

imposing liability on insiders, the deletion of the subsection imposing liability on outsiders, without material change in the other subsection, indicates that Congress ultimately decided to exclude outsiders from the operation of the statutory presumption. If Congress had intended for outsiders to be covered by the statute, logically it would have either altered the language of the remaining

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imparted that information to a stockholder, it would be contrary to this law.

Mr. CORCORAN. If that were confidential, and if the stockholder to whom the tip was imparted knew it was confidential and should not have been disclosed. . . .

Then, if there were any profit in the 6 months swing in the stock, the company would get the profit.

Senator CAREY. Suppose he did not say it was confidential, but said they had a good well coming in tomorrow, and this fellow went out and bought some stock?

Mr. CORCORAN. The person who is being sued by the company, if he can show that he had no reasonable ground to believe that the disclosure was confidential or was made not in the performance of corporate duties, would not be liable.

Senator BARKLEY. How can the digging of an oil well be confidential? Anybody who passes along would see it.

Mr. CORCORAN. I do not know anything about the oil business.

Senator CAREY. The information is not always given out.

Senator GORE. They can tell whether they are going to produce, or whether it is a dry well.

Senator BARKLEY. They cannot tell until they finish.

Senator CAREY. I do not see how you can determine when the information is confidential and when it is not.

Mr. CORCORAN. That would depend, sir, upon the nature of the business of the company and the nature of the information.

Senator CAREY. Suppose he said, "I have a letter here today from our man out in the field, and I am certain from what he says that we are going to have a good well." The man goes out into the market and buys.

Mr. CORCORAN. Whether that is a revelation of confidential information depends upon all the circumstances surrounding the case.

Senator CAREY. I think you are breeding a lot of lawsuits here.

Senator GORE. If he says, "strictly between us two," that would be confidential.

1934 Hearings, supra, note 5, at 6560-61.

subsection to provide expressly for such coverage or amended the language of the separate subsection to overcome the objections. Thus, we conclude that the class encompassed by subsection (b)(2) (statutory insiders) was not intended to include outsiders. *See* 9 Stan. L. Rev. 582, 588 n.32 (1957).

Since a person who decides to purchase enough stock to increase his holdings to 10 percent of a corporation's outstanding shares is an outsider at the time he makes his investment decision, he does not fall within the class of persons to which the conclusive presumption was intended to apply. He may have made that decision on the basis of inside information, but such inside information could not have been acquired, in the language of the statute, "by reason of his relationship to the issuer," or in the language of the Supreme Court, "from substantial stockholdings that did not yet exist." *Kern County Land Co.*, 411 U.S. at 597. We hold that the initial purchase by which a person increases his holdings to 10 percent of a corporation's outstanding stock is not a section 16(b) transaction and that the conclusive presumption imputing an intent to speculate does not apply to such a person who sells within six months. The statutory language "at the time of," in order to be consistent with the rationale of the statutory presumption, must be construed to mean prior to the time when the decision to purchase is made.

This construction, however, should not be applied to a transaction that is not an initial purchase but in reality is a repurchase or a closing transaction. It would be inconsistent with the rationale of the presumption and with the

legislative history to allow a principal shareholder to sell his holdings below the 10 percent level and then repurchase at a profit within six months.[8] Where a shareholder was within a class of persons who had access to inside information by reason of their relationship to the issuer prior to making his initial decision to speculate, the conclusive presumption should be applied if simultaneously with the conclusion of the closing transaction he is the owner of 10 percent of the issuer's stock. Although this conclusion mandates that the language "at the time of" means *prior to* in the case of an initial transaction and *simultaneously with* in the case of a closing transaction, we do not believe that this "inconsistency" is inconsistent with the rationale of the section. In order for the statutory presumption of intention or expectation to deter speculation rather than to impose an arbitrary hardship on a good faith investor, it must apply only to shareholders who, at the time they make the decision to purchase or to sell, are within the class of persons who can reasonably be expected to have access to inside information by reason of their relationship to the corporation. This conclusion does not provide a consistent construction of the language "at the time of" for both the initial and the closing transactions, but it is consistent with the rationale

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[8]One example of the speculative abuse of inside information that the section was designed to prevent was reported to Congress as follows:

> In another case, the president of a corporation testified that he and his brothers controlled the company with a little over 10 percent of the shares; that shortly before the company passed a dividend, they disposed of their holdings for upward of $16,000,000 and later repurchased them for about $7,000,000, showing a profit of approximately $9,000,000 on the transaction.

S. Rep. No. 792, 73d Cong., 2d Sess. 9 (1934).

of section 16(b)—a consistency that we believe is much more important than the consistency of terms. It is also consistent with the Supreme Court's instruction that

> where alternative constructions of the terms of § 16(b) are possible, those terms are to be given the construction that best serves the congressional purpose of curbing short-swing speculation by corporate insiders.

Reliance Electric Co. v. Emerson Electric Co., 404 U.S. 418, 424 (1972) (footnote omitted). *See Kern County Land Co. v. Occidental Petroleum Co.*, 411 U.S. 582, 595 (1973). *See also* 9 Stan. L. Rev. 582, 588 n.3 (1957).

With this construction, section 16(b) should be relatively easy to apply. Every section 16(b) fact situation involves a pair of transactions—an initial transaction and a closing transaction. If the defendant is a statutory insider prior to making his decision to enter the initial transaction—regardless of whether it is a purchase or a sale—the conclusive presumption imputing to him an intent to speculate on inside information must be applied if simultaneously with the closing transaction—regardless of whether it is a sale or a repurchase—he is the owner of 10 percent of the issuer's stock and if both transactions have occurred within six months.

We concede that this construction of section 16(b) will not prevent all of the abuses of inside information. A person may well have had inside information at the time he makes a purchase that makes him a 10-percent shareholder. But he may also have had inside information at the time he makes a purchase that makes him a 9-percent shareholder. Additionally, a 10-percent shareholder who sells and repurchases *after* six months may have made the

decision to do so on the basis of inside information. But in order for the conclusive presumption to apply to the transactions, the person must have had access to information at the time of the initial transaction and have executed the closing transaction within six months. If liability is imposed without either of these requirements having been satisfied, the rationale of the presumption will be destroyed. Section 16(b) was not intended to prevent all abuses of inside information, but only speculative abuses of inside information by statutory insiders. Persons injured by other abuses must seek a remedy in other securities laws. *Blau v. Max Factor & Co.*, 342 F.2d 304, 307 (9th Cir.), *cert. denied*, 382 U.S. 892 (1965). For example, a person injured in connection with the sale or purchase of securities because of the abuse of material inside information may have a remedy under section 10(b) of the Securities Exchange Act and rule 10b-5. *See Shapiro v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, ... F.2d ..... (2d Cir. April 3, 1974); *Mitchell v. Texas Gulf Sulphur Co.*, 446 F.2d 90 (10th Cir.), *cert. denied*, 404 U.S. 1004 (1971); *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 848 (2d Cir. 1968); *cert. denied*, 394 U.S. 976 (1969); *In re Cady, Roberts & Co.*, 40 S.E.C. 907 (1961). Although an injured person may be required to prove actual abuse in these cases, such cases do not fall within the ambit of those practices that Congress felt were so injurious to the investment community as to require a conclusive presumption once the fact of short-swing trading at a profit is proved.

In this case Provident was not a statutory insider at the time of its initial purchase. The only possible section

16(b) transaction was the sale of the debenture to Underwriters. Foremost has not alleged a closing transaction within six months of this initial transaction. Absent a pair of section 16(b) transactions within the statutory period, no liability can attach.

AFFIRMED.

Appendix C

FEDERAL STATUTES

Securities Exchange Act of 1934, §§ 3a(13), 3a(14) (15 U.S.C. § 78(c)(13), (14); 48 Stat. 882, 884):

> "(a) When used this chapter, unless the context otherwise requires—
>
> • • • • •
>
> (13) The terms 'buy' and 'purchase' each include any contract to buy, purchase, or otherwise acquire.
>
> (14) The terms 'sale' and 'sell' each include any contract to sell or otherwise dispose of."

Securities Exchange Act of 1934, §§ 16(a), 16(b) (15 U.S.C. § 78p(a), (b); 48 Stat. 896):

> "(a) Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to section 78*l* of this title, or who is a director or an officer of the issuer of such security, shall file, at the time of the registration of such security on a national securities exchange or by the effective date of a registration statement filed pursuant to section 78*l*(g) of this title, or within ten days, after he becomes such beneficial owner, director, or officer, a statement with the Commission (and, if such security is registered on a national securities exchange, also with the exchange) of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close of each calendar month thereafter if there has been a change in such ownership during such month, shall file with the Commission

(and if such security is registered on a national securities exchange, shall also file with the exchange), a statement indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month.

"(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

FEDERAL REGULATIONS

17 C.F.R. 240.16a-4, in pertinent part:

"(a) During the period of 12 months following their appointment and qualification, securities held by the following persons shall be exempt from sections 16(a) and 16(b) of the act:

* * * * *

"(3) Receivers, trustees in bankruptcy, assignees for the benefit of creditors, conservators, liquidating agents, and other similar persons duly authorized by law to administer the estate or assets of other persons."

CALIFORNIA CORPORATIONS CODE

§ 4600:

"Any corporation may elect to wind up its affairs and voluntarily dissolve by the vote or written consent of shareholders or members representing 50 percent or more of the voting power."

§ 4605:

"When a voluntary proceeding for winding up has commenced, the corporation shall cease to carry on business except to the extent necessary for the beneficial winding up thereof, and except during such period as the board of directors may deem necessary to preserve the corporation's good will or going-concern value pending a sale of its business or assets, or both, in whole or in part. The directors forthwith shall cause written notice of the commencement of the proceeding for voluntary winding up to be given by mail to all shareholders and to all known creditors and claimants whose addresses appear on the records of the corporation."

§ 5000:

"After determining that all the known debts and liabilities of a corporation in the process of winding up have been paid or adequately provided for, the directors shall distribute all the remaining corporate assets among the shareholders and owners of shares according to their respective rights and preferences. If the winding up is by court proceeding or subject to court supervision, the distribution shall not be made until after the expiration of any period for the presentation of claims which has been prescribed by order of court."

SUPREME COURT, U. S.

Supreme Court, U. S.
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Supreme Court of the United States

OCTOBER TERM, 1975

74-858
74-859

HUGH L. CAREY, Governor of the State of New York, LOUIS J. LEFKOWITZ, Attorney General of the State of New York, SIDNEY A. FINE, Justice of the Supreme Court of the State of New York, First Judicial District and GEORGE BEISHEIM, JR., Justice of the Supreme Court of the State of New York, Ninth Judicial District,

Appellants, (74-858)

and

CURTIS CIRCULATION COMPANY, CONTINENTAL COMPANY,

Appellants, (74-859)

against

BERT RANDOLPH SUGAR and WRESTLING REVUE, INC.,

Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR APPELLANTS CAREY, FINE, BEISHEIM AND ATTORNEY GENERAL *PRO SE*

LOUIS J. LEFKOWITZ
Attorney General of the
State of New York
Attorney for Defendants-Appellants Carey, Fine, Beisheim and pro se and also pursuant to New York Executive Law § 71
Office & P.O. Address
Two World Trade Center
New York, New York 10047
Tel. (212) 488-3396

SAMUEL A. HIRSHOWITZ
First Assistant Attorney General

A. SETH GREENWALD
Assistant Attorney General
of Counsel

249 Press of Fremont Payne, Inc., 417 Canal St., N. Y.—966—6570

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Supreme Court of the United States

OCTOBER TERM, 1975

74-858
74-859

HUGH L. CAREY, Governor of the State of New York, LOUIS J. LEFKOWITZ, Attorney General of the State of New York, SIDNEY A. FINE, Justice of the Supreme Court of the State of New York, First Judicial District and GEORGE BEISHEIM, JR., Justice of the Supreme Court of the State of New York, Ninth Judicial District,

Appellants, (74-858)

and

CURTIS CIRCULATION COMPANY, CONTINENTAL COMPANY,

Appellants, (74-859)

against

BERT RANDOLPH SUGAR and WRESTLING REVUE, INC.,

Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR APPELLANTS CAREY, FINE, BEISHEIM AND ATTORNEY GENERAL *PRO SE*

Opinions Below

1. Opinion of the District Court, convening three-judge court. 377 F. Supp. 1055, June 17, 1974 (J.S. 19a).*

2. Opinion of three-judge District Court declaring New York Civil Practice Law and Rules 6201(4), (5) and (8) unconstitutional. 383 F. Supp. 643, October 17, 1974 (J.S. 1a).

3. Probable jurisdiction noted. —— U.S. ——, 43 L. Ed. 2d 773, April 14, 1975.

Jurisdiction

Appellants invoke the jurisdiction of this Court pursuant to 28 U.S.C. § 1253. The judgment appealed from was entered November 6, 1974 (J.S. 31a). Notices of Appeal were filed on November 27 and 29, 1974 (J.S. 33a, 35a). Probable jurisdiction was noted April 14, 1975, Opinion Below.

Questions Presented

1. Does New York Civil Practice Law and Rules, Article 62, 6201 *et seq.*, violate any due process requirements of the Fourteenth Amendment to the United States Constitution in the procedure provided for the issuance of judicially supervised orders of attachment?

2. Is there a lack of a meaningful opportunity to vacate orders of attachment in New York?

(a) Is the "burden of proof" really on appellees in moving to vacate, and is such a burden the dispositive due process consideration on such motions?

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* Numbers in parentheses refer to Appendix (a) or Appendix to Jurisdictional Statement (J.S. a).

3. Is the existence of a vendor's lien or possessory interest crucial to the constitutionality of an attachment statute?

Statute Involved

New York Civil Practice Law and Rules (CPLR), Article 62 (6201 *et seq.*) (Attachment) (reproduced in full at J.S. 37a-49a).

The specific portions of Article 62 set out in Appendix A to this Brief are: CPLR 6201, subd. (4), (5) and (8) but including all of 6201; 6211, 6212, 6222, and 6223.

Statement of the Case

The instant action was instituted to challenge the constitutionality of an attachment granted by a New York state court on the grounds specified in New York Civil Practice Law and Rules (CPLR) 6201(4), (5) and (8). The plaintiffs-appellees claim that such an attachment of their property granted *ex parte* violates their Fourteenth Amendment rights to due process. Federal jurisdiction was alleged under 28 U.S.C. §§ 1331(a) and 1343(3) and (4).

In August, 1971, Champion Sports Publishing Inc. ("Champion") through appellee Bert Sugar entered into a written agreement with appellant Curtis Circulation Company ("Curtis") (42a). It provided that Curtis would distribute magazines for Sugar and Champion. Under the agreement, Curtis was to and did make advances to Champion which, by virtue of the contract, Curtis was entitled to recoup from moneys received by Champion as a consequence of the distribution of the latter's magazines (55a-56a). The agreement was to run five years.

In accordance with the agreement Curtis advanced between August, 1971 and December, 1972 over $100,000 to

Champion (42a). According to the affidavit of Stuart J. Friedman, in support of the application for the order of the attachment in the State Supreme Court (42a-44a) it was believed that Sugar caused Champion and appellee Wrestling Revue to enter into an operation to defraud Curtis of its rights as a creditor. Six of the publications subject to the agreement were transferred by Champion to Wrestling for no consideraiton in November, 1972. Wrestling thereupon sold the publications to an independent third party for a consideration, none of which was paid to Champion (43a). There was a licensing agreement, which was either a fraud or contrivance to avoid the agreement between Champion and Curtis (44a). Curtis stated the basis of the above allegations as information obtained in meetings between the attorneys for the third party, National Sports and Curtis on March 2, 1973 (44a). After the several assignments Champion had no assets (45a). Thus Champion had received large sums of money from appellant Curtis, but stripped itself of assets so as to be unable to repay (46a, 50a). As of February 28, 1973, Curtis had advanced payments of $28,588.08 which had not been recouped. It sought the attachment for that amount (45a).

Curtis knew nothing of the alleged ownership of the publications by Wrestling. It thought they were Champion's. This was alleged to be fraud (52a). The complaint, stating several causes of action in fraud and breach of contract was annexed to the moving papers for the order of attachment (47a-54a).

Having learned all this, Curtis notified National Sports to withhold payment (36a). National did so (16a, 37a). Wrestling sued National, March 5, 1973 (16a, 36a-37a). Then Curtis sued Sugar, Wrestling and Champion, April 13, 1973 (16a). Curtis also obtained the order(s) of attachment, the subject matter of the federal action and the instant appeal (39a-41a), pursuant to grounds found in

CPLR 6201(4), (5) and (8). This, of course, was *ex parte* and by order of a Justice of the Supreme Court of the State of New York Sidney A. Fine, one of the appellants herein.

The application was grounded on three alternative grounds all involving elements of fraud and deceit. One ground was based on CPLR 6201, subparagraph (4):

> "the defendant, with intent to defraud his creditors, has assigned, disposed of or secreted property, or removed it from the state or is about to do any of these acts."

to wit:

> (a) "Champion Sports has assigned disposed of or removed property from the State of New York with intent to defraud its creditors".

The second ground was based on Subparagraph (5):

> "the defendant, in an action upon a contract, express or implied, has been guilty of a fraud in contracting or incurring the liability".

to wit:

> (b) "Champion Sports and Sugar, its principal officer, have been guilty of a fraud in contracting or incurring a liability upon an express contract" and

The third ground was based on Subparagraph (8):

> "there is a cause of action to recover damages for the conversion of a personal property, or for fraud or deceit".

to wit:

> (c) "Champion Sports, Sugar and Wrestling Revue are liable to Curtis for damages in a cause of action for fraud and deceit".

It was supported by the affidavit of Stuart J. Friedman, (Corporate Secretary of Curtis) (41a-46a), a complaint (47a-54a), a copy of the contract (55a-57a), and a financial work sheet (58a) (§ 6212[a]). Also a bond of $10,000 was posted (§ 6212[b]). This was in an amount set by the State court to cover damages in the event of wrongful attachment (§6212[b]).

Rather than moving under § 6223 to vacate the attachment the state court defendants (Sugar and Wrestling Revue) instituted the instant action in federal court to, in effect, review the action of the state court in granting the attachment.*

Prior Proceedings

Upon filing the complaint in federal court, the plaintiffs-appellees applied for the convening of a three-judge court pursuant to 28 U.S.C. §§ 2281, 2284. The appellants Curtis and Continental opposed and moved to dismiss. The single judge District Court, despite the holding of *Mitchell* v. *W. T. Grant Co.*, 416 U.S. 600 (1974) and recognizing the numerous similarities between the New York law and the Louisiana statute upheld in *Mitchell*, denied the motion to dismiss and convened a three-judge court (J.S. 15a, 377 F. Supp. 1055). In passing, the single judge (LASKER, D.J.) rejected claims that the money which had been attached was being withheld anyway (J.S. 17a-19a) so as to avoid the constitutional claim and that the federal court should defer to the state court which had issued the attachment, where there was an action pending and could decide the issues (J.S. 19a-22a). After recognizing the similarities, the convening decision saw the creditor in *Mitchell* as having a (1) possessory interest and vendor's lien in the property

* The pendency of the state court action and the obvious multiplicity of suits, raises a serious issue as to whether comity and federalism required dismissal of the federal action. *Huffman* v. *Pursue, Ltd.*, —— U.S. ——, 43 L. Ed. 2d 482 (Mar. 18, 1975).

attached and (2) the proof of the above could readily be established on documentary proof. Judge Lasker did not see the challenged New York provisions as capable of such simple proof (J.S. 29a).

Upon presentation to the three-judge court, Judge Lasker again wrote the opinion and struck down the New York attachment statute. Continuing the point-by-point comparison to the Louisiana statute upheld in *Mitchell, supra,* the opinion stated that CPLR 6223 ("vacating or modifying attachment") is the sole mechanism available to the defendant to vacate an attachment and it did not meet the standards of *Mitchell,* Art. 3506, Louisiana Code of Civil Procedure (La. C.C.P.) (J.S. 8a). It held that the sole basis of vacating an attachment in New York under the CPLR was that the attachment "is unnecessary to the security of the plaintiff", and the burden is on the defendant moving to vacate, not the plaintiff, as in *Mitchell* (J.S. 9a).

Furthermore, it was asserted that appellant Curtis never had a legally cognizable, concurrent possessory interest in the property attached. It only had a claim of fraud (J.S. 10a).* The question of fraud was seen as "ill-suited" for preliminary *ex parte* determination.

In summary, *Mitchell* was seen as a narrow exception to the "general rule" of *Fuentes* v. *Shevin,* 407 U.S. 67 (1972) and the statute, CPLR 6201 (4), (5) and (8), was invalidated by the general *Fuentes* rule.

However, the CPLR was found unconstitutional only to the extent "a New York defendant has no meaningful opportunity to vacate an order of attachment . . ." (J.S. 12a).

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* Curtis may very well have had a lien on the moneys attached, as it had advanced them to Champion under a contract. This could be said to be an equitable lien created by implication. 35 N.Y. Jur., *Liens,* § 15.

The holding, as being based on the asserted lack of a meaningful opportunity to vacate the attachment, was confirmed by the signing of a judgment enjoining enforcement of CPLR Article 62, 6201(4), (5) and (8) "until and unless a meaning opportunity to vacate an attachment is provided . . ." (J.S. 32a). The Sheriff was ordered to release the attachment. However, the judgment was stayed on condition the defendants file a notice of appeal to the Supreme Court (32a).

The defendants, all except the Sheriff, who never appeared, did appeal (J.S. 33a, 35a) and this Court noted probable jurisdiction on April 14, 1975 —— U.S. ——, 43 L. Ed. 2d 773.

The Background of Attachment

The provisional remedy of attachment is found in the Civil Practice Law and Rules, Article 62, which itself was a simplification and modification of the former Civil Practice Law, §§ 902-973. Attachment can be used to perform two separate functions, although both can be found in certain cases. One is to establish a jurisdictional basis which allows the court to act when personal jurisdiction cannot be obtained. The second is to provide the plaintiff with security for the satisfaction of any judgment he might obtain in the action. An attachment order allows the Sheriff to levy on defendant's property. CPLR 6211.

The instant action is concerned with attachment for security purposes, the second example above. Such an attachment preserves a *res* out of which to satisfy a judgment should plaintiff prevail because it seems likely he will have difficulty enforcing his judgment. See generally 7A Weinstein-Korn-Miller, *New York Civil Practice*, ¶ 6201.01 *et seq.*

In New York, attachment is statutory in origin. *Penoyar* v. *Kelsey*, 150 N.Y. 77, 44 N.E. 788 (1896). It is issued

only by a judge, in strict compliance with the law, *Penoyar, supra.* Even then the judge must exercise discretion. Indeed the word "may" in the first paragraph of CPLR 6201 makes it clear the judge must exercise discretion. Attachment never is granted as of right. If the attachment serves none of the two purposes specified above, it is vacated. *Elliott* v. *Great Atlantic & Pacific Tea Co.,* 11 Misc 2d 133, 171 N.Y.S. 2d 217 (N.Y. City Ct., 1957), affd. 11 Misc 2d 136, 179 N.Y.S. 2d 127 (App. T., 1st Dept. 1958).

Summary of Argument

I. The District Court, in declaring New York's attachment statute unconstitutional, proceeded on several fallacious assumptions, which ultimately led to an erroneous result. Under CPLR 6223, attachment may be vacated on several grounds, including that the attachment is unauthorized in the action or that the grounds for attachment are insufficient. The District Court's contention that the only grounds to vacate are that the attachment "is unnecessary to the security of the plaintiff" is not correct and rebutted by numerous decisions in New York.

The issues on the motion to vacate (CPLR 6223) are as broad as in Louisiana in the statute approved in *Mitchell* v. *W. T. Grant Co.* (La. C.C.P. 3506). In neither case are the ultimate merits of the action inquired into. In both cases, the grounds for sequestration or attachment are tested with the burden on the plaintiff to justify the initial grant of the writ.

The plaintiff must show "facts" to justify the issuance of the writ and if they are contested by defendant (burden of going forward) justify his grounds further (the burden of proof). In any event, the issue of where the burden is placed on a motion to vacate is not of constitutional significance. Due process is a flexible concept which is well served by the New York statute.

II. It is not proper to confine the writ of attachment to instances where the plaintiff holds a pre-existing property interest lien in the property attached. There is absolutely no support for the curious notion of the District Court that the remedy of attachment must constitutionally be confined to those having such a pre-existing property interest. Historically the attachment procedure has been available in both state and federal courts to plaintiffs without regard to such pre-existing property interest, conserving of property to satisfy a judgment in the subsections of New York's statute at issue, § 6201 (and the others) is a sufficient basis, and overcomes any debtor interest in immediate access to property. Protection against fraud is an important state interest. Inquiry into "intent" is highly protective of debtors, and more so than in Louisiana.

This Court's decision in *Di-Chem* does not afford support to this notion since this Court did not mention the lack of a vendor's lien as a defect in the Georgia garnishment statute. The District Court failed to consider that grounds for attachment must be viewed within the flexibility due process undoubtedly possesses.

POINT I

There is no basis under *Mitchell* and *Di-Chem* to constitutionality challenge the State's commercial protective procedure of attachment upon due process grounds. On the contrary the statute affords a defendant ample basis for challenge and requires a judge to be satisfied that a *prima facie* showing of merit has been made by a plaintiff.

As has been noted by this Court, the constitutional validity of pre-judgment provisional attachment or garnishment remedies, granted *ex parte,* has been a continuing matter of concern. For the fourth time in less than four years, the due process aspects of a long-accepted provisional remedy is brought up for plenary consideration. See *North*

Georgia Finishing, Inc. v. *Di-Chem, Inc.*, —— U.S. ——, 42 L. Ed. 2d 751, 95 S. Ct. 719 (1975), dissent of BLACKMUN, J., 42 L. Ed. 2d at 761. The instant appeal present the substantial question of the adequacy of a statutory provision for vacating or modifying attachment granted initially *ex parte* by a judicial officer who must be satisfied that procedural requirements and adequate merit has been presented to him.

There is no doubt that primarily, or perhaps exclusively (in view of the judgment signed below), the three-judge District Court declared CPLR 6201(4), (5) and (8) unconstitutional, not because of any constitutional due process flaw in the initial granting of attachments. Rather the attachment granted was deemed unconstitutional because of the alleged inadequacy of the *vacatur* machinery. CPLR 6223.

A. The District Court Erroneously Limited the Basis for Vacatur to "Unnecessary Security".

Here unconstitutionality was not premised on what Section 6223 said but rather on what it did not say. Based upon its reading of New York decisional law, the three-judge District Court concluded that the sole basis for vacating an attachment is (1) "not that the grounds . . . are unproven, but the attachment 'is unnecessary to the security of the plaintiff' " and (2) the burden of proof is on the defendant moving to vacate (J.S. 9a).

Both propositions contain basic fundamental errors as to the State of New York law, even assuming *arguendo*, that the points are of constitutional significance in light of *Mitchell* and *Di-Chem*. These errors of the District Court in reading state law have been pointed out in several state court decisions rendered since the opinion under review. None have accepted the three-judge court's conclusion that there is no meaningful opportunity to vacate an attachment via Section 6223. This is so as these state cases demon-

strate that the "necessity" of the attachment is not the sole grounds for vacating an attachment in New York.*

Thus in *Regnell* v. *Page,* New York Law Journal (N.Y.L.J.) May 23, 1975, p. 14, c. 2 (Sup. Ct., N.Y. Co. FEIN, J.) (reproduced in full as an appendix to this brief) the state court noted the reliance of the *Sugar* court on the "unnecessary to the security of plaintiff" ground (CPLR 6223) as the sole basis for vacating an attachment. In reply, it said:

> "Such an interpretation, however, misconstrues the statute. A motion to vacate under CPLR 6223 on the ground that the attachment is unnecessary to the security of the plaintiff is but one of several available bases. Vacatur may be premised on the grounds among others, that the attachment is unauthorized in the action, or that the ground for attachment relied upon is insufficient".

If the facts are challenged on defendant's motion to vacate, an appropriate hearing can be ordered *Regnell* v. *Page,* N.Y.L.J. July 9, 1975, p. 11, c. 7, at c. 8, and *Regnell, supra.*

Authoritative on this point of availability of several and additional grounds is also *Maitrejean* v. *Levon Properties,* 45 A D 2d 1020, 358 N.Y.S. 2d 203 (2d Dept. 1974). There the plaintiff obtained an attachment, in part pursuant to CPLR 6201(4), removing property (or about to) with intent to defraud creditors, one of the subsections at issue. On appeal, it was said:

> "As respects defendant Levon, plaintiffs have failed to establish any intent to defraud creditors. Such in-

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* The decision (J.S. 8a), calls section 6223 the "sole mechanism available to a defendant who seeks to vacate the attachment". This, in a sense, is erroneous as CPLR 6222 permits discharge of the attachment by posting a bond. Vacatur (6223) or discharge (6222) have the same ultimate purpose—i.e., ending the attachment.

> tent may not be presumed from the mere disposition or removal of property (*Eaton Factors Co.* v. *Double Eagle Corp.*, 17 A D 2d 135)."

Or as propounded in *Macmillan, Inc.* v. *Hafner*, 42 A D 2d 533, 344 N.Y.S. 2d 729 (1st Dept. 1973), where an appeal also was taken on denial of a motion to vacate an attachment:

> "At best, respondent presented but a scintilla of proof as to the requisite elements of the fraud cause of action alleged in the complaint. Such a perfunctory showing falls short of the requirements to support the drastic remedy of attachment".

Another decision vacating an attachment, apparently granted under section 6201(8), according to the opinion* is *Richman* v. *Richman*, 41 A D 2d 993, 344 N.Y.S. 2d 52 (3rd Dept. 1973), where that state appellate court said:

> "The warrant [attachment] was issued 'for the wrongful and unlawful conversion of personal property and/or for fraud or deceit; and is an action upon a contract or stipulation wherein defendant has been and is, guilty of fraud and deceit in contracting and incurring said liability.' The only affidavit in support thereof, while using the conclusory words 'false and fraudulent', fails to set forth facts to sustain such allegations and the affidavit, when read in its entirety, at best, spells out an action for specific performance due to a breach of (stipulation) contract. * * * The present record is totally insufficient to sustain the issuance of the writ . . ."

See also *Martin Enterprises, Inc.* v. *M. S. Kaplan Co.*, 45 A D 2d 883, 358 N.Y.S. 2d 160 (2d Dept. 1974), where it

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* However we read it as also grounded in section 6201(5), although the papers did not designate under what subdivision of section 6201 the proceeding was commnced.

was said in vacating an attachment:

> "The affidavits, complaint and exhibits establish nothing more than that appellant held a controlling number of shares in the corporation with which plaintiff contracted. *There is not the least bit of evidence to establish the commission of the intentional torts pleaded.*" (Emphasis supplied)

Attachment may fail due to *forum non conveniens*, as another example. *Sutton* v. *Garcia*, 80 Misc 2d 690, 363 N.Y.S. 2d 695 (Sup. Ct., N.Y. Co. 1974). On wrong forum, *Gaskin* v. *Stumm Handel GmbH*, 390 F. Supp. 361, 363 (S.D.N.Y. 1975).

In fact the District Court's citation of cases (J.S. 9a) on "the sole basis" or burden of proof rests on non-resident defendant attachment decisions, *Hydromar Corp. of Delaware* v. *Construction Aggregates Corp.*, 32 A D 2d 749, 300 N.Y.S. 2d 797 (1st Dept. 1969); *George A. Fuller Co.* v. *Vitro Corp. of America*, 26 A D 2d 916, 274 N.Y.S. 2d 600 (1st Dept. 1966).* In these cases the "necessary to security of plaintiff" grounds is a matter that lies peculiarly within the defendant's knowledge. *Cf. Maitrejean, supra*, as to assets of foreign corporation.

Another experienced state court judge in *New York Auction Co.* v. *Belt*, N.Y.L.J. April 9, 1975, p. 17, c. 3 (Sup. Ct. N.Y. Co., *Silverman*, J.), also stated that *Sugar* had misinterpreted New York law:

> "Furthermore, the Sugar case seems to have proceeded on the assumption that an attachment may only be vacated in New York on a showing that it is not necessary for security purposes, and not because the plaintiff is unable to prove the grounds on which the

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* There is language in *Freedman* v. *Wilson Securities Corp.*, 31 A D 2d 627, 295 N.Y.S. 2d 789 (1st Dept. 1964), that the "unnecessary" clause can apply to all attachments.

attachment was issued, as the Mitchell case seems to require. In this respect, I think the court in the Sugar case misinterpreted the laws of the State of New York. It is an established practice in this State to vacate attachment not only where the attachment is unnecessary for security purposes, but also where it appears either that the plaintiff does not have a meritorious case or that the defendant is not a nonresident or foreign corporation. (cits. omitted).

"The court in the *Sugar* case relied upon the following sentence in CPLR 6223: 'If, after the defendant has appeared in the action, the court determines that the attachment is unnecessary to the security of the plaintiff, it shall vacate the order of attachment'. Apparently, the court in the *Sugar* case thought that was the only ground for vacating an attachment. But, the legislative history makes clear that this is merely an additional ground added to the existing ground for vacating an attachment in situations where an attachment initially used to obtain jurisdiction is no longer necessary for that purpose. See Third Preliminary Report, Leg. Doc. No. 17, p. 358 (1959); cf. McKinney's Supplementary Commentary (1964) to sec. 6223 at Supp. p. 47; *Data Realty Inc.* v. *Sciacca* (App. Term 2d Dept.) NYLJ, p. 22, col. 5 (May 18, 1970). It is the first sentence of CPLR sec. 6223 which is the successor to sections 948 and 949 of the Civil Practice Act (Sixth Report) on the Revision of the Civil Practice Act, Leg. Doc. No. 8, p. 591 (1962), and like those sections, seems to provide the defendant with a right to move to vacate the attachment on the ground that it is not authorized by the statute, including because the plaintiff is unable to prove that the defendant is a nonresident or foreign corporation." (cits. omitted).

B. Contrary to the District Court, the state law does provide a meaningful opportunity to vacate.

The District Court in its opinion below dwells at great length on the notion that a motion under § 6223 does not go to the ultimate merits (J.S. 9a-10a) and therefore concludes that the motion to vacate does not provide a "meaningful opportunity" to defendant. This ignores the fact that attachment is a "provisional remedy" which is not granted because the plaintiff is bound to prevail on the merits, but rather because there is a demonstrated need to preserve assets pending the conclusion of the action. Indeed, the plaintiff who obtains an attachment (CPLR Art. 62), does not receive possession of defendant's property but the attached property remains in possession of the sheriff. The District Court ignored or overlooked the important fact that the plaintiff must present "prima facie the existence of a cause of action" and "(t)he essential elements of the cause of action must be supported by evidential proof." *Aerotrade, Inc.* v. *Banque Nationale De La Republique D'Haiti*, 376 F. Supp. 1286, 1287 (S.D. N.Y. 1974).

The same type of hearing, on the grounds for attachment, is given under Louisiana C.C.P. Section 3506. The trial of the merits of the action is not involved under the Louisiana statute (and *Mitchell*) and equally so in New York under CPLR § 6223. See *Tucker & Schonekas* v. *Al Dohmann Chevolet, Inc.* (La. App.), 260 So. 2d 99, 100-101 (1972):

> "Official Revision Comment (c) under Article 3506 states that only the grounds for the auxiliary remedy, i.e., dissolution of the writ and damages for wrongful sequestration may be inquired into on the motion to dissolve and not the merits of the main demand".

Thus, both in Louisiana as approved in *Mitchell*, and New York, under CPLR 6223, a defendant may not present defenses to the complaint to vacate the attachment

but can only contest the adequacy of plaintiff's proof for granting attachment. Furthermore such a limitation on issues to be litigated at a preliminary stage does not make the procedure unconstitutional. See *Lindsey* v. *Normet*, 405 U.S. 56, 64 (1972), cited in *Mitchell* at 607, where this Court held it was "unable to conclude that . . . limitation on litigable issues is invalid on its face under the Due Process Clause of the Fourteenth Amendment". See also, 88 Harvard Law Review 71, *The Supreme Court, 1973 Term*, 76, n. 35.

C. Burden of proof is on the plaintiff. It is the burden of going forward that is on a defendant.

The hearing provided in New York (§ 6223) is as broad as the hearing in Louisiana. The only rational distinction is in the fact that the "burden of proof" is stated in Louisiana as on the plaintiff when a motion to vacate is presented (C.C.P. 3506) while in New York the defendant, who makes the motion is, commonly said to have the burden, although not so stated in the statute. See generally Weinstein-Korn-Miller, 7A *New York Civil Practice* ¶ 6223.05. However this statement of where the burden lies is a simplification, which is of form, not substance. See, *infra*.

In actuality the burden of proof to show entitlement to attachment rests on the plaintiff-moving party. This includes showing of a *prima facie* case. This is verified by numerous New York decisions.

As cited in *Regnell, Stines* v. *Hertz Corp.*, 22 A D 2d 823, 254 N.Y.S. 2d 903 (2d Dept. 1964), affd. 16 N Y 2d 605, 261 N.Y.S. 2d 59 (1965) states:

> "While the court is not required to decide the merits of a controversy on a motion to vacate an attachment 'the attachment papers must contain evidence from which the court can determine that the ultimate facts alleged in the complaint can be substantiated (*Krellberg* v. *Gregory*, 10 A D 2d 824), where the complaint

> and affidavits fail to establish a prima facie cause of action, or where they clearly establish that the plaintiff must ultimately be defeated', the attachment must be vacated (*American Reserve Ins. Co.* v. *China Ins. Co.*, 297 N.Y. 322, 325)."

See also *Macmillan, Inc.* v. *Hafner, supra.* 42 A D 2d 533, 344 N.Y.S. 2d 729.

In New York, the party seeking the attachment has to carry a significant burden of proof in order to convince a judge to exercise his *discretion* and grant an *ex parte* order. The litigant *"shall show"* (6212[a]) that he has a cause of action and grounds for attachment exist. This is fundamental. This is not a mere formality. This was pointed out by District Judge Weinfeld in the *Aerotrade* case, *supra,* where he pointed out that the federal court follows the state procedure on attachment and insists upon this showing of merits by plaintiff (see also, 376 F.Supp. at 1288): "Upon the record presented there is sufficient doubt that plaintiffs have *prima facie* established their claims as to warrant denial in the exercise of the court's discretion of the motion for the issuance of a warrant of attachment"). As to grounds, see *Eaton Factors Co., Inc.* v. *Double Eagle Corp.*, 17 A D 2d 135, 232 N.Y.S. 2d 901 (1st Dept. 1967).

And the facts of the instant case show this to be the case. The complaint in the state court stated a number of well-pleaded causes of action for fraud (47a-58a), and the affidavit in support of attachment contained specific reasons for the attachment based on information and belief together with the basis of the affiant's statements (44a-45a). Indeed, the affidavit was characterized by the opinion below as "extensive and detailed" (J.S. 2a).* Attachments

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* This was hardly the case in *Mitchell* v. *W.T. Grant, supra,* 416 U.S. 600 at 605, 616, where La. C.C.P. 3501 provides for an

(*footnote continued on following page*)

under New York law are not granted on perfunctory allegations.

And, when the motion to vacate is made, while the courts on the motion to vacate do not actually try the merits of the case, they do delve into plaintiff's showing of entitlement. To quote *Boston Old Colony Ins. Co.* v. *Bianchi*, N.Y.L.J., February 26, 1975, p. 16, c. 1 (Sup. Ct. N.Y. Co. *Helman* J.):*

> "On the present application [under 6223] elaborate affidavits and exhibits have been submitted on both sides bearing on the factual and legal issues involved, so as to provide movant with a full and fair hearing. While conflicts exist, there can be little doubt that the plaintiff's supporting affidavits establish prima facie, a showing of fraud and conversion, sufficient to charge defendant with responsibility and culpability in the activities complained of by plaintiff."

In light of the fact that the plaintiff has sustained a significant burden of proof in initially obtaining the order, on a motion to vacate it is not at all unreasonable that the defendants have a burden of "going forward", to dispute the basis of the attachment by showing that it was unauthorized. This may be called a "burden of proof" (J.S.

(*footnote continued from preceding page*)

affidavit showing "the nature of the claim and the amount thereof, if any, and the grounds relied upon for the issuance of the writ clearly appear from specifications . . ." However, as stated in the dissent of Justice Stewart, 416 U.S. at 632, "(t)he Louisiana affidavit requirement can be met by any plaintiff who fills in the blanks on the appropriate form documents and presents the completed forms to the court". And at 633—". . . issuance of the summary writ becomes a simple ministerial act" and footnote 4 thereto.

It also was not the case in *North Georgia Finishing, Inc.* v. *Di-Chem, Inc.*, —— U.S. ——, 42 L. Ed. 2d 751, 756, n. 2.

* This is another state court decision rendered since *Sugar* that has declined to follow it.

9a), but is seen as really the burden of going forward. The plaintiff must always in the end justify his right to attachment as the cited cases establish.

Apart from that, the reliance below upon the burden of proof on vacatur has not the crucial significance as to the constitutionality of granting *ex parte* attachments* accorded to it on the disposition by the District Court. When attachments are granted as a matter of course on routine affidavits, some significance may be placed upon the burden of proof at a vacatur hearing. This was the case in *Mitchell*,** and *Di-Chem*. But given the significant initial and ultimate burden of the plaintiff in New York (to persuade the judge to exercise his discretion and grant attachment) the fact that the burden of going forward shifts during the proceeding is clearly not of constitutional significance. *United States* v. *Illinois Central R.R. Co.*, 291 U.S. 457, 463-464 (1934).

Flexibility in deciding what due process requires is the keynote of *Mitchell*. The decision below treated *Mitchell* as

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* As was said by Joseph M. McLaughlin, *New York State Trial Practice*, New York Law Journal, November 8, 1974, p. 1, at p. 4, c. 1 (Mr. McLaughlin is Dean of the Fordham Law School in New York and the author of the Practice Commentary to the CPLR Art. 62):

> "Properly analyzed the only substantive difference between the statute sustained in *Mitchell* and the CPLR provision lies in the burden of proof. Whereas in *Mitchell*, the burden that the seizure was authorized rested upon the attaching creditor, under New York law the burden rests upon the defendant debtor to show that the attachment is unauthorized. The ultimate question, therefore, is whether this difference in burden of proof is of constitutional proportions. This writer remains unpersuaded that it is." (Footnote omitted.)

** It must be recognized that in *Mitchell* in every county, save the one where the writ of sequestration was issued, the court clerk was the issuing agent. It cannot be presumed the state judge in *Mitchell* applied higher standards than the court clerk in other counties, when granting the sequestration.

setting inflexible standards without any consideration of the highly discretionary nature of attachment in New York and the practical difficulty of obtaining such a "drastic remedy", *Macmillan, Inc.* v. *Hafner* (*Mitchell,* 416 U.S. at 610), *supra.* Considered "as a whole", the New York procedure has made a constitutional accommodation of the respective interests of the parties to the litigation. On issues of interpreting state law and procedures, the state courts, of course, are the ultimate authority. *O'Brien* v. *Skinner,* 414 U.S. 524, 531 (1974) and the District Court should have considered itself bound by the law as set out in relevant New York cases. The error below principally was occasioned by misapplication of the state law.

POINT II

The remedy of attachment is not confined only to creditors holding pre-existing interest in the property subjected to same. There is no basis for any constitutional limitation of the provisional remedy of attachment to those such pre-existing interests.

While a vendor's lien, or claim of ownership of property, may not be in the *sine qua non* of attachment in New York, it is a fanciful notion to claim that thereby there is a violation of due process. In *Mitchell* (416 U.S. at 628) (POWELL, J., concurring), this Court did not find in *Fuentes* (407 U.S. 67), a "Procrustean rule of a prior adversary hearing" before seizure of property. But it did not intend to establish a vendor's lien as a Procrustean condition of attachment. While the existence of a vendor's lien may be easy to establish (*Mitchell* at 609), the interests of debtors and creditors can and must be considered in other situations. The very fact that New York in Section 6201(4), (5) and (8) the grounds for attachment are more difficult to prove than Louisiana's in *Mitchell*

furnish no basis for condemning the New York statute for being more protective of debtors.

In any event, it is necessary to apply a balancing test. The Court's opinion in *Mitchell* recognized that the state's interest in establishing pre-judgment attachment are two-fold. The first is to conserve property which is the subject of dispute from waste or alienation by a debtor which protects the creditor's interests in the property. This preserves credit and enhances the flow of commerce. The second is to avert self-help measures by a creditor, which may be accompanied by violence and retaliation. *Id.* at 605. These themes are considerations in New York's statute making attachment available in specified instances. CPLR 6201 (1) through (8). This is especially so in the instant attachment involving a commercial transaction.

The element of a fraud cause of action found in attachments granted under Section 6201(5) and (8) are easy to determine and do consist of specific elements, all of which are necessary to state a valid cause of action. 24 N.Y. Jur. *Fraud and Deceit*, § 14 (representation of a material existing or pre-existing fact, falsity, scienter, deception and injury). If any of the elements are lacking, there is no sufficient complaint. Such a preliminary determination is properly a judicial function, with the judge exercising his discretion.

While Sections 6201(5) and 6201(8), the two bases for issuance of the state attachment, were not seen in the conveniency opinion below as following *Mitchell* as closely as Section 6201(4), it "presumably embodies the inference that fraudulent activity by a defendant giving rise to a lawsuit may indicate the defendants' willingness to commit fraud to avoid payment of a judgment resulting from the lawsuit" (J.S. 28a). This is echoed in 1973 Practice Commentary (McLaughlin 1973) to CPLR 6211 (7B McKinney's [6001-7700] Pocket Part, pp. 27-28):

> "CPLR 6201(8) authorizes an attachment in an

action to recover for conversion of fraud. If the defendant has committed the act charged in the complaint, one can readily predict what his action will be when he notified that the plaintiff is going to seek an order of attachment. Query: If there is a reasonable fear that the defendant will hide his assets to protect them from attachment, is this not a sufficient reason to permit the plaintiff to proceed ex parte?"

Contrary to the absence of judicial scrutiny found to be a constitutional vice in *Di-Chem,* as a preliminary matter in authorizing the attachment, it is necessary for a judge in his judicial capacity to make a determination of the complaint's sufficiency. The granting of an attachment is not a determination of the ultimate merits of the case. By not making the vendor's lien the basic criterion of attachment, New York is more protective of the debtor than Louisiana. In the latter, Louisiana C.C.P. Art. 3571 allows sequestration on a simple claim of ownership, or a mortgage, lien or privilege thereon, "if it is within the power of the defendant to conceal, dispose of, or waste the property of revenues . . ." Note there is no issue as to actual *intent* of the defendant. *Cf.* CPLR 6201(4) which requires 'intent' to defraud", not just the ability or power. And Section 6201(5) requires a contract, which in the instant case was express and part of the application for the attachment (55a-56a).

The grounds on which attachment shall be available is still a matter for the State legislature. As was said in *Rothschild* v. *Knight,* 184 U.S. 334, 341 (1902), that "(t)o what actions the remedy of attachment may be given is for the legislature of a state to determine and its courts to decide . . .".

It was not the lack of a vendor's lien or its general availability which led the Court to strike down Georgia's attachment statute in *Di-Chem, supra.* Indeed, the

vendor's lien was not even mentioned. See *Hutchinson* v. *Bank of North Carolina*, —— F.Supp. ——, 43 L.W. 2441, 2442 (c. 2) (4-29-75), pointing out that *Mitchell* is not confined to statutes that afford a prejudgment remedy only to creditors holding a pre-existing interest in the property subjected to the writ.

A statute such as New York's undisputably contains most and, on analysis, all of the safeguards referred to in *Di-Chem*. *Di-Chem*, *id.* at 757, is not lacking in due process simply because of lack of a vendor's lien. The Court's opinion therein lays stress on *Mitchell's* (Louisiana's) writ of attachment sequestration being issuable only by a *judge* upon a sufficient affidavit.

It is apparent that the District Court placed an indefensible stress on the absence of a pre-existing possessory lien. With such a misconception, it ignored basic guidelines in determining due process. As said in *Mitchell*, *supra*, at 610 and left undisturbed by *Di-Chem*:

> "The requirements of due process of law 'are not technical, nor is any particular form of procedure necessary'. *Inland Empire Council* v. *Millis*, 325 U.S. 697, 710 (1945). Due process of law guarantees no particular form of procedure; it protects substantial rights. *NLRB* v. *Mackay Co.*, 304 U.S. 333, 351 (1938). The very nature of due process negates any concept of inflexible procedures universally applicable to every imaginable situation'. *Cafeteria Workers* v. *McElroy*, 367 U.S. 886, 895 (1961); *Stanley* v. *Illinois*, 405 U.S. 645, 650 (1972)".

CONCLUSION

The judgment below should be reversed.

Dated: New York, New York
May 27, 1975

Respectfully submitted,

LOUIS J. LEFKOWITZ
Attorney General of the
State of New York
Attorney for Defendants-Appellants Carey, Fine, Beisheim and pro se and also pursuant to New York Executive Law § 71

SAMUEL A. HIRSHOWITZ
First Assistant Attorney General

A. SETH GREENWALD
Assistant Attorney General
of Counsel

Appendix A.

Text of sections of statute involved, New New Civil Practice Law and Rules.

§ 6201. Ground for attachment.

An order of attachment may be granted in any action, except a matrimonial action, where the plaintiff has demanded and would be entitled, in whole or in part or in the alternative, to a money judgment against one or more defendants, when:

1. the defendant is a foreign corporation or not a resident or domiciliary of the state; or

2. the defendant resides or is domiciled in the state and cannot be personally served despite diligent efforts to do so; or

3. the defendant, with intent to defraud his creditors or to avoid the service of summons, has departed or is about to depart from the state, or keeps himself concealed therein; or

4. *the defendant, with intent to defraud his creditors, has assigned, disposed of or secreted property, or removed it from the state or is about to do any of these acts;* or

5. *the defendant, in an action upon a contract, express or implied, has been guilty of a fraud in contracting or incurring the liability;* or

6. the action is based upon the wrongful receipt, conversion or retention, or the aiding or abetting thereof, of any property held or owned by any governmental agency, including a municipal or public corporation, or officer thereof; or

7. the cause of action is based on a judgment, decree or order of a court of the United States or of any

other court which is entitled to full faith and credit in this state, or on a judgment which qualifies for recognition under the provisions of article 53; or

8. *there is a cause of action to recover damages for the conversion of personal property, or for fraud or deceit.* (emphasis supplied on subsections invalidated from court judgment).

§ 6211. Order of attachment.

An order of attachment may be granted without notice, before or after service of summons and at any time prior to judgment. It shall specify the amount of the plaintiff's demand, be indorsed with the name and address of the plaintiff's attorney and shall be directed to the sheriff of any county or of the city of New York where any property in which the defendant has an interest is located or where a garnishee may be served. The order shall direct the sheriff to levy within his jurisdiction, at any time before final judgment, upon such property in which the defendant has an interest and upon such debts owing to the defendant as will satisfy the plaintiff's demand together with probable interest, cost, and sheriff's fees and expenses.

Rule 6212. Motion papers; undertaking; filing; demand.

(a) Affidavit; other papers. On motion for an order of attachment the plaintiff shall show, by affidavit and such other written evidence as may be submitted, that there is a cause of action and the one or more grounds for attachment provided in section 6203* that exist and the amount demanded from the defendant above all counterclaims known to the plaintiff.

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* So in the original. Probably should read "6201". (See 7B McKinney's, CPLR 6001 to 7700, p. 58, after text of R. 6212.)

(b) Undertaking. On a motion for an order of attachment the plaintiff shall give an undertaking, in a total amount fixed by the court, but not less than two hundred fifty dollars, a specified part thereof conditioned that the plaintiff shall pay to the defendant all legal costs and damages which may be sustained by reason of the attachment if the defendant recovers judgment or if it is finally decided that the plaintiff was not entitled to an attachment of the defendant's property, and the balance conditioned that the plaintiff shall pay to the sheriff all of his allowable fees. The attorney for the plaintiff shall not be liable to the sheriff for such fees.

(c) Filing. Within ten days after the granting of an order of attachment, the plaintiff shall file it and the affidavit and other papers upon which it was based and the summons and complaint in the action. Unless the time for filing has been extended, the order shall be invalid if not so filed, except that a person upon whom it is served shall not be liable for acting upon it as if it were valid without knowledge of the invalidity.

(d) Demand for papers. At any time after property has been levied upon, the defendant may serve upon the plaintiff a written demand that the papers upon which the order of attachment was granted and the levy made be served upon him. Not more than one day after service of the demand, the plaintiff shall cause the papers demanded to be served at the address specified in the demand. A demand under this subdivision shall not of itself constitute an appearance in that action.

§ 6222. Discharge of attachment.

A defendant whose property or debt has been levied upon may move, upon notice to the plaintiff and the

sheriff, for an order discharging the attachment as to all or a part of the property or debt upon payment of the sheriff's fees and expenses. On such a motion, the defendant shall give an undertaking, in an amount equal to the value of the property or debt sought to be discharged, that the defendant will pay to the plaintiff the amount of any judgment which may be recovered in the action against him, not exceeding the amount of the undertaking. Making a motion or giving an undertaking under this section shall not of itself constitute an appearance in the action.

§ 6223. Vacating or modifying attachment.

Prior to the application of property or debt to the satisfaction of a judgment, the defendant, the garnishee or any person having an interest in the property or debt may move, on notice to each party and the sheriff, for an order vacating or modifying the order of attachment. Upon the motion, the court shall give the plaintiff a reasonable opportunity to correct any defect. If, after the defendant has appeared in the action, the court determines that the attachment is unnecessary to the security of the plaintiff, it shall vacate the order of attachment. Such a motion shall not of itself constitute an appearance in the action.

Appendix B—Regnell v. Page.

New York Law Journal, May 23, 1975, p. 14, c. 2
SUPREME COURT,
NEW YORK COUNTY.

SPEC. TERM, PART I.

Justice Fein

REGNELL v. PAGE—Motion by defendants to reargue that portion of their prior motion which sought vacatur of the order of attachment in this action, which was denied by order dated June 27, 1974, is deemed a motion for renewal and is granted. Upon reconsideration, the court adheres to its original determination sustaining the order of attachment.

Plaintiffs, as trustees of welfare and pension funds, sue to recover for the fraud of defendants in breach of collective bargaining and trust agreements, which required defendants to make payments or contributions to such funds to provide benefits to employees based upon the number of employee hours worked. Periodic reports were to be submitted detailing employee hours and the amount due. Payments were to be made to the funds pursuant to the reports, subject to a later audit. Plaintiffs allege the deliberate submission of false reports, causing the funds to become substantially underpaid, as disclosed by an audit which revealed the existence of a double set of bookkeeping records at least as to one of the companies.

The prior decision (New York Law Journal, July 9, 1974, p. 11, c. 7), declined to hold CPLR article 62, the attachment article, unconstitutional to the extent that it permits attachment without prior notice in an action to recover a money judgment on the grounds of fraud and deceit. In reliance upon Mitchell v. W. T. Grant Company (416 U. S. 600), it was held that the New York attachment

statute affords sufficient safeguards in that it permits an immediate test of the validity of the attachment by motion to vacate, constituting an adversary hearing where the facts are challenged or are in dispute.

The decision noted the important governmental and general public interest in honestly financing and properly maintaining employee welfare and pension trust funds, designed for the protection of employees and as a form of deferred compensation. An employer's failure to make employee welfare and pension contributions is made criminal (N. Y. Labor Law, sec. 198[c]), and personal liability is imposed on the ten largest shareholders of corporations which fail to make such contributions (N. Y. Business Corporation Law, sec. 630). There also exists a certain priority in insolvency proceedings for claims involving welfare and pension contributions (N. Y. Debtor and Creditor Law, sec. 22).

Defendants' motion for reargument is premised upon the authority of Sugar v. Curtis Circulation Company (383 F. Supp. 643), decided almost four months after the prior decision. That case held that the New York attachment statute, in particular, CPLR sec. 6201(4)(5) and (8), and CPLR sec. 6211, was unconstitutional to the extent that the challenged provisions collectively permit attachment merely upon plaintiff's ex parte allegation that defendant had defrauded him. The court stated, at 383 F. Supp. p. 650, "a New York defendant has no meaningful opportunity to vacate an order of attachment granted ex parte and without prior notice."

With all due respect to the Sugar court, this court adheres to the prior determination that upon the facts and circumstances of this case, the New York attachment statute meets the requisites of procedural due process laid down in Mitchell. The decision of the Sugar court, albeit a three-judge federal court, is not controlling, although it is entitled to serious consideration (8 N. Y. Jur., Constitutional Law sec. 45; 147 A.L.R. 857; Zurich Gen.

A. & L. Ins. Co., Ltd. v. Lackawanna S. Co., 164 Misc. 498; aff'd 254 App. Div. 839, revd. 279 N. Y. 495, revd. 307 U. S. 265, reh. den. 307 U. S. 650 and 308 U. S. 631).

State court decisions subsequently rendered have upheld the constitutionality of the attachment statute, despite the Sugar decision. (Marshall, Bratter, Greene, Allison & Tucker v. Knight, N. Y. L. J., Dec. 20, 1974, p. 2, c. 3; Salerno v. Salerno, N.Y.L.J. Jan. 24, 1975, p. 18, c. 2; Boston Old Colony Ins. Co. v. Bianchi, N. Y. L. J., Feb. 26, 1975, p. 16, c. 1; New York Auction Co. v. Belt, N. Y. L. J., April 9, 1975, p. 17, c. 3; also see McLaughlin, New York Trial Practice, N. Y. L. J., Nov. 8, 1974, p. 1, cols. 1 and 2).

The federal court has stayed its decision in Sugar pending an appeal to the Supreme Court of the United States. Upon review, it appears that the principles stated in Mitchell do not warrant the extremely broad Sugar holding. The New York attachment statute, in its protective features, appears closer in form and substance to the statute upheld in Mitchell than to those declared invalid in (Fuentes v. Shevin, 407 U. S. 67). "[T]he narrow door of constitutionality left open in Mitchell", to adopt the phrase employed by the district court in Sugar, is sufficiently ajar to permit the New York statute to "squeeze through" as comfortably as did the Louisiana statute upheld in Mitchell.

Fuentes held unconstitutional Florida and Pennsylvania replevin statutes which permitted a secured installment seller to repossess goods which had been sold, without notice or hearing and without judicial order or supervision, upon a mere writ of replevin issued by the court clerk. There was no requirement of a convincing showing before seizure. All that was necessary was the bare asssertion on entitlement by the party seeking the writ. There was no opportunity for an immediate hearing until trial of the court action for repossession. The court held the seizure violative of due process standards, since it was carried

out without notice or opportunity for hearing and without judicial supervision.

Although, in sustaining the Louisiana sequestration statute, Mitchell departed from some of the broad pronouncements in Fuentes, the Mitchell court carefully noted that the Louisiana statute was substantially different from the Florida and Pennsylvania provisions invalidated in Fuentes: (1) the sequestration order could be issued only where the grounds relied upon clearly appeared from the affidavit or petition submitted in support of the writ; (2) judicial approval of the writ of attachment was required; (3) there was judicial control of the process from beginning to end; (4) the attaching creditor was obligated to post a bond; (5) the debtor (defendant) had the right to regain possession of the property or extinguish the attachment, by posting a bond; (6) the statute entitled defendant (debtor) to seek dissolution of the writ immediately to be granted unless the "creditor proves the grounds upon which the writ issued", and "failing which the court may order return of the property and assess damages in favor of the debtor, including attorneys fees."

The three judge court in Sugar, observing that the New York attachment statute is strikingly similar to the Louisiana sequestration statute in all respects but one, invalidate the New York statute on the ground that it does not guarantee defendant an opportunity for an immediate post-seizure hearing, at which the plaintiff must prove the grounds upon which the writ was issued. The court asserted that the sole basis for vacating an attachment under the CPLR is that the attachment is unnecessary to the security of the plaintiff. Such an interpretation, however, misconstrues the statute. A motion to vacate under CPLR 6223 on the ground that the attachment is unnecessary to the security of the plaintiff is but one of several available bases. Vacatur may be premised on the grounds, among others, that the attachment is unauthorized in the action, or that the ground for attachment relied upon

is insufficient. There does exist an opportunity for an immediate post-sezure hearing. Defendant, at any time before application of the property or debt attached to the satisfaction of a judgment, may move, on notice, for an order vacating or modifying the order of attachment. As observed in this court's original decision, where the facts are challenged upon such a motion, an appropriate hearing may be ordered.

Thus viewed, the only difference between the Louisiana and New York statutes is that the New York statute, unlike Louisiana, does not state that upon a motion by defendant to dissolve the writ, the attachment is to be vacated unless plaintiff proves the grounds upon which the writ was issued. Sugar, citing New York authorities holding that defendant has the burden of proof upon such a motion concludes that this difference between New York and Louisiana is of constitutional significance. That due process is necessarily violated by imposing the burden of proof on a defendant is not nearly as clear as Sugar suggests (Leland v. Oregon, 343 U. S. 790; U. S. v. Ill. Central RR., 291 U. S. 457).

Moreover, the New York authorities are not so definitive as Sugar posits as to the burden of proof, except as to non-resident corporate defendants with only transitory assets in New York, as was the case in the most recent New York decisions cited in Sugar (Hydromar Corp. of Delaware v. Construction Aggregates Corp., 32 A. D. 2d 749; George A. Fuller Co. v. Vitro Corp. of America, 26 A. D. 2d 916).

Thus, in Stines v. Hertz Corp., 22 A. D. 2d 823, aff'd 16 N. Y. 2d 605, the court, in vacating an attachment, otherwise grounded, stated, at 22 A. D. 2d, p. 823:

"While the court is not required to decide the merits of a controversy on a motion to vacate an attachment 'the attachment papers must contain evidence from which the court can determine that the ultimate facts alleged in the complaint can be substantiated (Krellberg v. Gregory, 10

A. D. 2d 824). Where the complaint and affidavits fail to establish a prima facie cause of action, or where they clearly establish that 'the plaintiff must ultimately be defeated', the attachment must be vacated (American Reserve Ins. Co. v. China Ins. Co., 297 N. Y. 322, 325)."

And, in a case more clearly like ours, where the issue is one of fraud and disposition and secretion of assets, and no question of jurisdiction is involved, it has recently been ruled, in vacating an attachment, in Macmillan, Inc. v. Hafner, 42 A. D. 2d 533:

"At best, respondent presented but a scintilla of proof as to the requisite elements of the fraud cause of action alleged in the complaint. Such a perfunctory showing falls far short of the requirements to support the drastic remedy of attachment."

Even assuming that the prevailing case law imposes the burden on the defendant, such rule is neither implicit in nor directed by the New York statute and therefore should not affect its constitutionality. This is patent from this very case, where the issue is immaterial, since defendants do not challenge the facts as asserted.

As observed in the original decision, the papers in support of the attachment indicate a concession by defendants that the reports were false and that underpayments were made. A hearing under such circumstances would have no valid purpose.

In addition, it is significant that here, as in Mitchell, both parties assert a real interest to be protected, which, under the principles of Mitchell, requires an accommodation or balancing of interests in the application of due process requirements, rather than the inflexible approach taken by the three judge federal court in Sugar. As the Supreme Court observed in Mitchell:

"To summarize, the Louisiana system seeks to minimize the risk of error of a wrongful interim possession by the creditor. The system protects the debtor's interest in every conceivable way, except allowing him to have the

property to start with, and this is done in pursuit of what we deem an acceptable arrangement pendente lite to put the property in the possession of the party who furnishes protection against loss or damage to the other pending trial on the merits" (Mitchell v. W. T. Grant Company, supra, 416 U. S. at p. 618).

In fixing and applying due process standards, there is a need for flexibility in balancing the interests of plaintiff and defendant, as recently stated in another context in Matter of Sanford v. Rockefeller (35 N. Y. 2d 557, at p. 563):

"The flexibility in approach to the balance to be struck in such cases can be seen in decisions of this court where we have measured the degree of essential due process to confirm to the petitioner's situation."

Here, plaintiff has an interest in the payments due the trust funds on behalf of defendants' employees, who also have an interest to be protected. The defendants oviously have an interest in the property attached. Moreover, as noted, there is manifestly an important governmental and general public interest in honestly financing and properly maintaining employee welfare and pension trust funds. Considering the New York procedure as a whole, it appears that, in accordance with the principles set forth in Mitchell in sustaining the Louisiana Statute, "the State has reached a constitutional accommodation of the respective interests" of all parties (Mitchell v. W. T. Grant Company, 416 U. S. at p. 610).

Of further significance is the fact that, although the attachment was based upon allegations of fraudulent conduct, there is also some evidence that defendants were about to leave the jurisdiction and that some of defendants' property had already been sold and converted into cash. The properties attached are apparently of businesses which are no longer operating and the attachment actually amounts to no more than a lien against defendants' real estate and possible accounts receivable. Nor has

the defendants' use and possession of the real property been interfered with. The only practical effect of the attachment is to prevent disposal of conveyance to a third party. As observed initially, these are not the kind of important interests required by the Supreme Court to be held immune from attachment prior to a hearing on notice.

Defendants are not aided by recent post-Sugar changes in the rules of the Civil Court of the City of New York (Notice, Thompson, J., N.Y.L.J., 10/3/74, p. 1, cols. 6 and 7) directing that all orders of attachment provide that plaintiff, within three days after levy, shall move on notice to the defendant, the garnishee and the sheriff, for leave to prove the grounds upon which the order of attachment was issued. The burden of proof on such a motion is on the plaintiff, and the attachment will be deemed vacated if such a motion is not made.

In the original decision on the motion, almost four months prior to the federal opinion in Sugar, it was suggested.

"Although CPLR article 62 does not now so provide, it may very well be appropriate, in the interests of due process, for the court to follow the practice used where an interim stay is granted in an order to show cause. The attachment order could incorporate a provision staying transfer of the property attached until an almsot forthwith return day fixed in the order, thus affording an immediate opportunity to be heard." (N.Y.L.J., 7-9-74, p. 11, c. 8).

Whatever the wisdom of such provisions which upon plaintiff both the burden of applying to the court for relief, and the additional burden of proof therein, the central issue here is the constitutional significance and effect of the failure of our Legislature to incorporate such a provision in the statutory scheme. It must be held that the absence of such provision is not of constitutional import under the facts and circumstances of this case. Plaintiffs have affirmatively estalished a valid basis, without contra-

diction by the defendants, to uphold the ex parte issuance of the order of attachment. The possession of the property by defendants is not affected. As the facts asserted and upon which the attachment order wa issued are not in dispute, there is no need for a formal hearing.

Serve a copy of this order with notice of entry without undue delay.

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IN THE

Supreme Court of the United States

October Term, 1974

Docket No. 74-758

PROVIDENT SECURITIES COMPANY,
a California Corporation,

Cross-Petitioner,

against

FOREMOST McKESSON, INC.,
a Maryland Corporation,

Cross-Respondent.

ANSWERING BRIEF OF CROSS-RESPONDENT

MORTON MOSKIN
Attorney for Cross-Respondent
Foremost-McKesson, Inc.
14 Wall Street
New York, New York 10005
(212) 732-1040

THOMAS McGANNEY
WHITE & CASE

PHILIP E. DIAMOND
LANDELS, RIPLEY & DIAMOND
Of Counsel

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ANSWERING BRIEF OF CROSS-RESPONDENT

Cross-Petitioner's Conditional Cross-Petition should not be granted. Cross-Petitioner itself explains why, when at page 10 of its Cross-Petition it concedes that "the questions presented might not be sufficiently important to justify an independent petition for a writ of certiorari." Moreover, the principal points raised by the Cross-Petition were dealt with correctly by the Ninth Circuit.

Cross-Petitioner's Statement of the Case (pp. 4-5) does however confirm the essential facts (as distinguished from Cross-Petitioner's argumentative characterization of them)

upon which Foremost's Petition (No. 74-742) is based. The undisputed facts set forth in the Cross-Petition in fact go counter to the arguments made by Cross-Petitioner. A few examples from the Cross-Petition follow:

(1) Underlying Questions 1 and 2 is Cross-Petitioner's continuing but erroneous stance that it did not of its own free will enter into an agreement to exchange certain of its assets for securities of Foremost-McKesson, Inc. As Question 1 is phrased:

> "* * * the recipient of the securities wished only to receive cash for its assets." (P. 3)

Question 2 puts it that securities were received:

> "* * * solely as an accommodation to the purchaser." (P. 3)

The refrain is repeated at page 11 where it is said that "Provident's sole motivation was to dispose of its assets in exchange for cash * * *" Yet the absence of any duress or coercion and the fully volitional nature of the agreement to exchange assets for securities is laid bare at pages 5 and 6 where it is admitted that "After investigation of various proposals, Provident decided to pursue negotiations * * *", and "Extensive negotiations followed between Provident and Foremost regarding the form of the transaction and the nature of the consideration to be paid. * * * Compromise eventually was reached under which Foremost agreed to take such steps as were necessary to accommodate the sale * * * of one-half of the securities to be transferred to Provident."

(2) As question 3 would have it, there should be read out of the law the statutory definition that a contract to

sell is a "sale". But at page 15 Cross-Petitioner appears to concede that the underwriting agreement was indeed a "firm commitment", and thus in truth a binding contract and thus a "sale". The summary of *Champion Home Builders Co.* v. *Jeffress*, 490 F. 2d 611 (6th Cir. 1974), *cert. denied*, 42 U.S.L.W. 3631 (May 14, 1974), upon which Cross-Petitioner relies (p. 15), is highly imprecise. The *Jeffress* court found that the statutory purchase occurred on the date the contract there in issue was executed, rather than on the date the corporate board adopted a resolution which the court characterized as "nothing more than an authorization to negotiate * * * no more than a license to bargain." 490 F. 2d at 617. It is the date of execution of the underwriting agreement that we submit, and the Ninth Circuit found, should be determinative here.

Page 8 discloses that Cross-Petitioner is at least consistent in its determination to ignore the statute's mandate that contracts to sell or purchase, as the case may be, do constitute sales or purchases. This time in the context of the agreement to exchange assets for convertible debentures it is suggested that "Prior to *receipt* of the debentures, Provident had no legal or beneficial ownership in any security of Foremost." (Emphasis added.)

Cross-Petitioner's formulations should be contrasted with the statutory definitions (Securities Exchange Act of 1934, §§3a(13), 3a(14) (15 U.S.C. §78(c)(13), (14); 48 Stat. 882, 884)):

> "(a) When used in this chapter, unless the context otherwise requires—
>
> * * *
>
> (13) The terms 'buy' and 'purchase' each include any contract to buy, purchase, or otherwise acquire.

> (14) The terms 'sale' and 'sell' each include any contract to sell or otherwise dispose of."

(3) Question 4 is bottomed on the unsupportable premise that the mere adoption by a corporation of a revocable plan of liquidation* converts the corporate owner of securities into a mere custodian or perhaps into some wholly passive kind of a trustee—presumably without reference to how long the condition persists.

As appears from page 9, "liquidation proceedings continued throughout late 1969 and 1970" and not until August 31, 1970 was Provident "declared dissolved by court order and its remaining assets * * * transferred to a liquidating trust." The concept is restated at page 16 in these words: "Provident's shareholders, not Provident, were in fact and in law the beneficial owners of these debentures." Not the least of the factual deficiencies in this novel theory is sharply illuminated at pp. 7-8 where Cross-Petitioner admits that its shareholders could not have received the Foremost-McKesson securities and resold them through underwriters because

> "it was impossible to get consents to sell from the minor shareholders without the appointment of guardians; in addition, one shareholder was somewhere in the Brazilian jungles and could not be contacted (R., pp. 397-398). To resolve this problem, Foremost agreed to a change in the Purchase Agreement so that Provident, instead of its shareholders, might sell the debentures."

---

* Cross-Petitioner does not, in its citation of the applicable state law, refer to Cal.Corp.Code §4606 which provides that a plan of liquidation can be revoked by a majority vote of the shareholders prior to distribution and §4618 which provides that the state court may, under certain circumstances, revoke an election to wind up and dissolve. (See Appendix A)

In so doing, Provident was hardly passive and was no more "acting solely for the benefit of its shareholders" (p 16) than every corporation is charged with doing in the ordinary course of its business.

(4) On page 10, in struggling to construct an argument that this was somehow an "unorthodox" transaction entitled to be measured by the pragmatic possibility of abuse test rather than the automatic presumption of abuse of inside information traditional standard, Cross-Petitioner posits that "in effect, Provident was merged into Foremost and it received cash and Foremost debentures as consideration in that merger." Although it is fundamental that in a merger the surviving corporation, by operation of statute law, succeeds to *all* of the disappearing corporation's assets and liabilities, Cross-Petitioner at page 6 recites that "The purchase agreement provided that Foremost would purchase approximately two-thirds of Provident's assets. . . ." In addition, the contract left all of Cross-Petitioner's tax liabilities and accrued pension and retirement plan liabilities with it. (R. 467) As to the disappearance of the subordinate "merger" partner, the Court is again referred to page 9 where the vanishing corporation is said not to have departed the scene until ten and one-half months later, when its dissolution was finally recognized by an August 31, 1970 court order.

The whole argument comes down to the assertion that Provident's payment of consideration other than cash for the stock somehow made the transaction "unorthodox": "if there is no cash involved, then there may not have been any wish to acquire the stock and, accordingly, no

intent to speculate." (P. 11) Why this might be so is not further explained, presumably because it is in the nature of all non sequiturs that they defy logical explanation. In any event, the operation of Rule 16(b) cannot swing on such fanciful distinctions between cash and other consideration; as this Court has said "'* * * Section 16(b) imposes strict liability upon substantially all transactions occurring within the statutory time period' * * *" *Reliance Electric Co.* v. *Emerson Electric Co.*, 404 U.S. 418, 422 (1972).

(5) Point II of the Cross-Petition is devoted to the argument that, assuming that the transaction was unorthodox, "the transaction involved no potential for actual speculative abuse." Cross-Petitioner purports to make this point by resort to the claim that "the presumption of access to inside information * * * can * * * be rebutted by other facts" (Page 12). Cross-Petitioner then proceeds to offer as support one "undisputed" alleged "fact"—*i.e.*, "there was no reason for Provident to have, and it did not have, any access to Foremost's books and records" (p. 13). No basis in the record is offered or can be found for this so-called "fact". Despite this, Cross-Petitioner would have the determination made—in the setting of what page 4 correctly describes as a motion for summary judgment—that it had no possible access to inside information.

Conclusion

The issues raised by Provident's Cross-Petition are not significantly important to warrant the attention of this Court. The only issue in this case worthy of the Court's

attention is the question presented in Foremost's Petition (Docket No. 74-742), a question fundamental in the interpretation of Section 16(b) which the Ninth Circuit has decided differently than every other Circuit Court which has considered the issue.

Respectfully submitted,

MORTON MOSKIN
Attorney for Cross-Respondent
Foremost-McKesson, Inc.

THOMAS MCGANNEY
WHITE & CASE

PHILIP E. DIAMOND
LANDELS, RIPLEY & DIAMOND
Of Counsel

January 15, 1975

Appendix A

California Corporations Code

§4606. Verification of authorization to wind up affairs: Certificate: Subscription, verification and filing: Contents. A voluntary election to wind up and dissolve may be revoked prior to distribution of any assets by the vote or written consent of shareholders or members representing no less than a majority of the voting power, or by resolution of the board of directors if the election was by the directors pursuant to Section 4601. Thereupon a certificate evidencing the revocation shall be subscribed, verified and filed in the manner prescribed by Section 4603.

The certificate shall set forth:

(a) That the corporation has revoked its election to wind up and dissolve.

(b) That no assets have been distributed pursuant to the election.

(c) If the revocation was made by the vote or written consent of shareholders or members, the number of shares or memberships voting for or consenting to the revocation and the total number of outstanding shares or memberships the holders of which were entitled to vote on or consent to the revocation.

(d) If the election and revocation was by resolution of the board of directors it shall be so stated.

* * *

§4618. Same: Revocation of election to wind up. The jurisdiction of the court includes the revocation of the election to wind up and dissolve by the shareholders, and the making of orders for the withdrawal and termination of proceedings to wind up and dissolve, subject to conditions for the protection of shareholders and creditors.

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In the Supreme Court of the United States

OCTOBER TERM, 1974

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PROVIDENT SECURITIES COMPANY, a California corporation,
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vs.

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Cross-Petitioner's Reply Brief

JOHN B. BATES
NOBLE K. GREGORY
WALTER R. ALLAN
225 Bush Street, 19th Floor
San Francisco, California 94104
Telephone: (415) 983-1000
Attorneys for Cross-Petitioner

PILLSBURY, MADISON & SUTRO
225 Bush Street, 19th Floor
San Francisco, California 94104
Telephone: (415) 983-1000
Of Counsel

SORG PRINTING COMPANY OF CALIFORNIA, 948 FIRST STREET, SAN FRANCISCO 94105

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Cross-Petitioner's Reply Brief

The Answering Brief (hereinafter "Answer") of cross-respondent Foremost-McKesson, Inc. (hereinafter "Foremost") is based upon a misunderstanding of the governing principles of law as well as a misunderstanding of the points presented in the cross-petition of Provident Securities Company (hereinafter "Provident"). As is discussed in our brief in opposition to Foremost's petition for a writ of certiorari, we believe that the opinion below is correct with respect to the ground upon which it affirmed the judgment and that it states a rule that will be easy to apply to all § 16(b) transactions. Even though we believe that the petition should be denied so as to enable the other

Circuits to consider the careful analysis made for the first time judicially by the Ninth Circuit, simple justice requires that—if the petition should be granted—all arguments should be considered by this Court.

We reply to Foremost's arguments in the order of the points raised in our cross-petition.

1. THE TRANSACTION WAS UNORTHODOX.

In contending that the transaction was orthodox (Answer, pp. 5-6), Foremost ignores this Court's ruling that orthodox transactions are "traditional *cash-for-stock* transactions" (*Kern County Land Co. v. Occidental Corp.* (1973) 411 U.S. 582, 593, emphasis added). Foremost also ignores the fact that Provident did not, as in a traditional cash-for-stock transaction, enter the market with cash seeking to purchase securities and did not pay cash for the securities. Rather, Foremost purchased Provident's assets in exchange for cash and debentures. And, the debentures were a part of the transaction only because Foremost did not wish to make its payment entirely in cash.

Although Foremost may not understand why transactions which are not traditional cash transactions may be exempt from § 16(b) (see Answer, pp. 5-6), this Court has made its position clear. Certainly, as Foremost observes, § 16(b) applies to "substantially all transactions occurring within the statutory time period" (Answer, p. 6, quoting from *Reliance Electric Co. v. Emerson Electric Co.* (1972) 404 U.S. 418, 422). However, Foremost has ignored the preliminary consideration, namely,

> "In interpreting the terms 'purchase' and 'sale,' courts have properly asked whether the particular type of transaction involved is one that gives rise to speculative abuse" (*Reliance Electric Co. v. Emerson Electric Co.* (1972) 404 U.S. 418, 424, ftn. 4).

Here, the record establishes only that a complete analysis of *Provident's* financial structure, assets and prospects was prepared (R., pp. 251-252). That analysis was made available to Foremost (ibid.). There was no reason for Provident to have, and there is nothing in the record which would show that it had, information about Foremost.

II. THE TRANSACTION INVOLVED NO POTENTIAL FOR ACTUAL SPECULATIVE ABUSE.

In contending that there did exist a potential for speculative abuse (Answer, p. 6), Foremost again misunderstands the rule set forth in this Court's opinion in *Kern County Land Co. v. Occidental Corp.* (1973) 411 U.S. 582. It is perhaps always possible to conceive of some possibility of access to inside information in any transaction. Foremost's arguments seem based upon the assumption that § 16(b) is directed against the possibility that one about to acquire some stock in a corporation may have information about that corporation.

Under *Kern*, however, it must be possible to assume or infer from the facts that a beneficial owner of shares had or was likely to have access to inside information *by reason of its ownership* so as to afford it an opportunity to reap speculative, short-swing profits (411 U.S. 596, 599).[1] As to this, the district court noted on the undisputed facts that:

> "[Foremost] makes no claim that any of the evils against which 16(b) were directed were present in this [transaction], or that Provident derived inside

1. Foremost's confusion is perhaps attributable to its refusal to recognize that § 16(b) is directed against unfair use of information obtained by an insider "by reason of his relationship to the issuer" and requires that, in the case of a beneficial owner only (as opposed to directors and officers), the relationship exist "both at the time of the purchase and sale" (15 U.S.C. § 78p(b); 48 Stat. 896).

> information, profit or advantage from its all-but-momentary status as an 'insider' of Foremost" (Appendix to Petition, p. ix).

In this regard, Foremost persists in its erroneous contention that all "voluntary" transactions are necessarily subject to § 16(b) without any examination of the underlying potential for speculative abuse (Answer, p. 2). That contention is, as was pointed out in Provident's cross-petition (at p. 13), contrary to this Court's decision in *Kern County Land Co. v. Occidental Corp.* (1973) 411 U.S. 582, 601-602, and was also rejected by the Second Circuit in *Blau v. Lamb* (2 Cir. 1966) 363 F.2d 507, 520.

Foremost also apparently does not understand that the facts to which it refers (at Answer, p.2) are, among others, relevant to the question of speculative abuse. Foremost does not and cannot refute those facts; namely, that Provident's sole motivation was to liquidate, that Provident did not want to receive any Foremost securities, and that Provident did so only as a result of a compromise. Indeed, as the district court pointed out,

> "In all its essential details the form of the transaction was insisted upon if not dictated by Foremost, often contrary to the plans and wishes of Provident. If the matter had been handled as Provident wished, this case could never have arisen" (Appendix to Cross-Petition, p. xi).

III. THE DATE OF THE SALE WAS THE DATE UPON WHICH POSSESSION AND OWNERSHIP WERE TRANSFERRED.

Foremost ignores, presumably because it cannot answer, the fact that the Ninth Circuit's decision with respect to the date of sale was based upon a misunderstanding of the terms of the underwriting agreement (see Provident's Cross-Petition, pp. 14-15). Instead, Foremost refers (An-

swer, pp. 3-4) only to the statutory definition of "sale" which provides no guidance as to the date of sale.

Here, the sale was pursuant to an underwriting agreement which defined October 28 as "the time of purchase" by the underwriters and provided that possession and the incidents of ownership would be transferred on that date. As pointed out in Provident's cross-petition (at pp. 14-15), Provident could have gained no speculative advantage from the underwriting agreement and therefore the date specified therein should be deemed to be the date of sale.

IV. THE TRANSACTION SHOULD BE DEEMED EXEMPT BECAUSE PROVIDENT ACTED AS A LIQUIDATING AGENT.

Foremost's arguments relating to Provident's status as a liquidating agent under California law seem to be based upon the possibility of the occurrence of events which did not in fact occur (see Answer, pp. 4-5). Neither the shareholders nor any state court revoked the election to liquidate. Rather, in accord with the plan of liquidation under state law, Provident planned to and did liquidate within a period of 12 months.

Provident's status was substantially different from a corporation acting in "the ordinary course of its business" (Answer, p. 5). It was charged by law with the obligation to "cease to carry on business except to the extent necessary for the beneficial winding up thereof" and to distribute the "corporate assets among the shareholders and owners of shares according to their respective rights and preferences" (Cal.Corp.Code §§ 4605, 5000; quoted at Appendix to Petition, pp. xliii-xliv).

CONCLUSION

For the foregoing reason, we respectfully submit that if Foremost's petition for a writ of certiorari should be granted, this conditional cross-petition should also be granted.

JOHN B. BATES
NOBLE K. GREGORY
WALTER R. ALLAN
Attorneys for Cross-Petitioner

PILLSBURY, MADISON & SUTRO
225 Bush Street, 19th Floor
San Francisco, California 94104
Of Counsel